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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-304

RICHARD A. GORDON, ETC., PETITIONER

v.

NEW YORK STOCK EXCHANGE, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

OPINIONS BELOW

The opinion of the court of appeals (436a)[1] is reported at 498 F. 2d 1303. The opinion of the district court is reported at 366 F. Supp. 1261.[2]

JURISDICTION

The judgment of the court of appeals was entered on June 28, 1974. The petition for a writ of certiorari was filed on September 19, 1974, and was granted on November 18, 1974. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

[1] References to the Appendix filed by petitioner are designated "... a."

[2] The opinion of the district court does not appear in the Appendix filed by petitioner.

QUESTION PRESENTED

The Securities Exchange Act of 1934 (the "Exchange Act") was enacted, in large measure, to provide for the regulation and control of this nation's securities markets, which were found, as noted in Section 2 of the Act, to be "affected with a national public interest" which made it "necessary to make such regulation and control reasonably complete and effective."

The comprehensive regulatory scheme of the Act placed major emphasis on the stock exchanges, which were and are the principal markets for equity securities, providing for the regulation of such exchanges, and securities transactions executed on them, in a variety of ways, including direct regulation by the Commission, and the imposition upon the exchanges of obligations to the public, as well as self-regulatory duties, to be carried out under the supervision and direction of the Commission.

The Commission will discuss the question whether that scheme of regulation, by which the Commission establishes policy for the governance of this nation's securities markets, should be superseded and disrupted by collateral antitrust suits against exchanges subject to the Commission's plenary regulatory jurisdiction, thus calling upon federal district courts to make isolated policy judgments on vital aspects of complex regulatory issues for which the Commission has responsibility.

At issue in this case is a particular, although significant, exchange practice—the fixing of commission rates —which has existed for 180 years, was recognized and subjected to Commission control by the Congress, and is now in the last stages of being phased out as a part

of an on-going major restructuring of the securities markets under Commission direction and Congressional oversight for nearly 15 years.

STATUTES INVOLVED

The pertinent provisions of the Securities Exchange Act of 1934 and the Sherman Antitrust Act are set forth in the appendix, *infra*, pp. 84-93.

STATEMENT

Petitioner, Richard A. Gordon, instituted this private antitrust action in 1971 against respondents New York Stock Exchange, Inc. ("NYSE"), American Stock Exchange, Inc. ("AMEX"), and two "representative" member firms of these securities exchanges,[3] charging that the exchanges' practice of requiring their members to charge non-members a fixed minimum commission rate for the execution of transactions on the exchange was a price-fixing conspiracy in violation of the Sherman Act, 15 U.S.C. 1 and 2 (10a). As pointed out by the Department of Justice, (DOJ Br.6) the plaintiff made other claims which are not before this Court.

The suit, which was brought by petitioner on his own behalf and on behalf of a purported class of "small investors," sought both injunctive relief and treble damages in the amount of $1.5 billion.

I. THE DISTRICT COURT DECISION

On December 4, 1973, the district court granted respondents' motion for summary judgment and en-

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[3] The two member firms named as defendants in the complaint were respondents Merrill Lynch, Pierce, Fenner & Smith, Inc., and Bache & Co., Inc. Respondents NYSE and AMEX are national securities exchanges registered as such with the Commission pursuant to Section 6(d) of the Exchange Act, 15 U.S.C. 78f(d).

tered an order dismissing the action for lack of subject matter jurisdiction. 366 F. Supp. at 1267.

The district court ruled it lacked jurisdiction to entertain petitioner's antitrust attack on the defendant exchanges' fixed rate systems because "the practices complained of are within the exclusive jurisdiction of the Securities and Exchange Commission, that the SEC, acting pursuant to Section 19(b) of the Exchange Act . . ., has been actively regulating these practices, and that, consequently, the practices are exempt from the provisions of the antitrust laws . . . ." *Id.* at 1262-1263. The court held that "the fixing of commissions falls squarely within the congressional policy of exchange self-regulation embodied in the 1934 Act" and that "the power to fix commission rates" was placed "within the exclusive jurisdiction of the Exchange, subject to Commission supervision." *Id.* The district court therefore disagreed with the decision in *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F. 2d 264 (C.A. 7), *certiorari denied,* 404 U.S. 994, insofar as *Thill* has been read as holding "that an antitrust court has concurrent jurisdiction with the SEC over *all* potentially anti-competitive practices and rules . . ." of a national securities exchange. *Id.* at 1267.

II. THE COURT OF APPEALS DECISION

On petitioner's appeal, the Commission and the Antitrust Division of the Department of Justice participated *amici curiae:* the Commission supporting the trial court's judgment, the Department of Justice urging reversal.

The Court of Appeals for the Second Circuit affirmed, stating that the requisite reconciliation between the antitrust laws and the scheme of regulation embodied in the Exchange Act must begin with an analysis of this Court's decision in *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (439a). It reasoned that in *Silver* the enforcement of an exchange rule was held subject to antitrust scrutiny because of the absence of Commission authority to review the particular exchange conduct involved, and that this Court acknowledged in *Silver* that "if there were Commission jurisdiction to review a challenged [exchange] rule, a different case would arise concerning antitrust exemption" (437a-438a). The court of appeals concluded that this case was that "different case," since under Section 19(b)(9) of the Exchange Act, 15 U.S.C. 78s(b)(9), supervisory authority over the fixing of commission rates is expressly vested in the Commission (440a-441a).

Finding that the exercise of antitrust jurisdiction in *Silver* was deemed proper because, in the absence of Commission jurisdiction, the assertion of judicial oversight would not result in a conflict "between agency and court" and the denial of antitrust jurisdiction "would have left no governmental body to perform the antitrust function," the court of appeals held that the existence of Commission review power supported a finding of antitrust immunity for the challenged exchange practice of fixing commission rates (441a).

The court of appeals cited additional support for its ruling concerning antitrust exemption. First, referring to the test enunciated in *Silver* that repeal of the antitrust laws is to be implied only to the extent

"necessary to make the Securities Exchange Act work," the court construed that test as necessarily contemplating a "core of exchange self-regulation necessary to make the 1934 Act work, and thus immune from application of the antitrust laws" (447a). It determined from the language of Section 19(b) of the Act, 15 U.S.C. 78s(b), that Congress had defined in that section those matters which it considered "fundamental to achieving 'the aims of the Securities Exchange Act' . . . and accorded the SEC authority to make whatever changes respecting those matters as are 'necessary or appropriate' . . . to effectuate those aims. . . ." (442a). It therefore concluded that, if a core of exchange self-regulation exempt from the antitrust laws is to have any meaning, it must necessarily "have reference to the practices enumerated in Section 19(b) and in this instance to the fixing of reasonable rates of commission" (442a). The court reasoned that if the exchanges were subjected to "duplicative or inconsistent standards announced contemporaneously by courts and Commission" with respect to matters enumerated in Section 19(b), the "inevitable consequence" would be to "render ineffective the supervised self-regulatory scheme designed to accomplish the aims of the Exchange Act (442a).

Second, the court of appeals noted that Congress' grant to the exchanges of "unique self-regulatory power . . . was conditioned upon the creation of the SEC, invested with broad discretionary powers equal to the complex and changing nature of the problems arising in the securities industry" (443a). The court

of appeals stated: "[A]s to several specific matters inextricably linked with [the Act's purposes] . . . the Commission was empowered by Section 19(b) to order exchanges to make such amendments in their rules as the Commission found necessary to carry out the purposes of the Act" (443a). In this framework the court of appeals reasoned that the regulation of the practice of fixing commission rates, which was vested in the Commission seven years after the holding in *United States* v. *Trenton Potteries,* 273 U.S. 392, 398, that price fixing is a *per se* violation of the Sherman Act, evidenced Congress' view "that the exchange commission rate system bore crucially upon achievement of the goals of the 1934 Act" (444a).

In light of the Commission's jurisdiction to regulate exchange rate fixing and of the congressional view that exchange rate fixing was important to achievement of the Exchange Act's goals, the court below perceived "sound policy considerations governing regulation of the securities industry" which mandated "exemption from the antitrust laws with regard to fixing of minimum rates of commission" (445a). It recognized that effective regulation of this important practice would be "too hazardous with two hands on the tiller" (445a). And it emphasized that, in contrast to this Court's acknowledged inability to assess price-fixing practices under a rule of reason standard,[4] the Exchange Act "exhibits congressional confidence that the Commis-

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[4] Citing *United States* v. *Trenton Potteries, supra,* 273 U.S. at 398.

sion will be more capable of resolving problems of this nature" (450a).[5]

Finally, the court of appeals—after observing that "it would be difficult to maintain" that the effect of the rule challenged in the *Thill* case is in any significant respect different from the practice of commission rate-fixing—stated that "to the extent our decision today is inconsistent with *Thill*, we find ourselves constrained to disagree with the holding there announced" (450a-451a).

THE INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities Exchange Act of 1934 was enacted to provide "reasonably complete and effective" regulation and control of transactions in securities as . . . conducted upon securities exchange . . . markets" and of "practices and matters related thereto. . . ." Section 2 of the Act, 15 U.S.C. 78b. In establishing a scheme of regulation over the stock exchange mechanism, Congress recognized that the exchange markets were "affected with a national public interest" and constituted a principal cornerstone of the national economy. *Id.* It sought by the Act to restore and maintain investor confidence in the securities markets—confidence considered vital to the economic welfare of the country—through the enactment of provisions which would protect public investors, insure fair dealing in securities traded on exchanges and insure fair

[5] The Court below also stressed that its decision "by no means implies that Gordon at no time may have access to the courts" since judicial review of action by an administrative agency is otherwise available (451a; 498 F. 2d 1311).

administration of such exchanges. See S. Rep. No. 1455, 73d Cong., 2d Sess., p. 5; H.R. Rep. No. 1383, 73d Cong., 2d Sess., pp. 3, 5. Congress effectuated these purposes through a statutory scheme under which the Securities and Exchange Commission was vested with regulatory authority over exchange activities.

As the federal agency responsible for administering the Exchange Act, the Securities and Exchange Commission is vitally concerned that its continued ability to administer its congressional mandate and to formulate and effectuate a cohesive regulatory policy for the securities industry is not crippled through unwarranted application of antitrust standards and *ad hoc* judicial decrees affecting that regulatory program.

Resolution in this case of the question of pre-emption of the antitrust laws in favor of the Commission's jurisdiction will have a material impact upon the effective exercise by the Commission of its supervisory authority over securities exchanges, not just with respect to stock exchange commission rates, but also with respect to the entire range of exchange activities that are subject to the Commission's jurisdiction under the Exchange Act. *See, e.g., Stark* v. *New York Stock Exchange,* 346 F. Supp. 217 (S.D.N.Y.), *affirmed per curiam,* 466 F. 2d 743 (C.A. 2); *J. R. Williston & Beane* v. *Haack,* CCH Fed. Sec. L. Rep. [Current Binder] ¶94,921 (S.D.N.Y.).

INTRODUCTION AND SUMMARY OF ARGUMENT

A basic purpose of the Exchange Act is to provide for the regulation of the securities markets with particular emphasis on stock exchanges. As this Court pointed out in *Silver* v. *New York Stock Exchange Inc.,*

373 U.S. 341, stock exchanges "perform an important function in the economic life of this country" in that they serve as an indispensable mechanism through which corporate securities can be bought and sold. Prior to the enactment of the Exchange Act these markets were largely unregulated. As the exchanges grew in importance, the inadequacies of this approach and the necessity of subjecting them to a comprehensive scheme of federal regulation became more and more apparent and culminated in the enactment of the Securities Exchange Act of 1934. As this Court put it in *Silver*, 373 U.S. at 351:

> "It was, therefore, the combination of the enormous growth in the power and impact of exchanges in our economy, and their inability and unwillingness to curb abuses which had increasingly grave implications because of this growth, that moved Congress to enact the Securities Exchange Act of 1934."

The exchanges, as membership organizations, had traditionally engaged in regulating the activities of their members. The Exchange Act preserved this pattern of self-regulation, but provided to a substantial extent for supervision by the Commission. In certain crucial areas, the Congress did not rely primarily upon supervised self-regulation but either granted to the Commission direct regulatory authority, as in the case of manipulative and deceptive practices, short selling, insider trading, and other matters. In other essential areas, Congress vested in the Commission plenary authority to supervise and direct the self-regulatory activities of the exchanges through a unique scheme of

formal and informal procedures. Commission rates were in this latter category.

Since the *Silver* case involved exchange self-regulation beyond the jurisdiction of the Commission, this Court was not faced with a need to reconcile the objectives of the antitrust laws with the purposes of the Exchange Act in those areas where Congress did provide for Commission control. This Court carefully pointed out in that case, 373 U.S. at 360:

> "Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented."

As the court below noted, this is that different case. (440a-441a). The exchange practice of fixing commissions, which has existed since 1792, has obvious anticompetitive implications. On the other hand, until recently this practice has been deemed significant in the functioning of the exchanges, both in attracting members to the exchanges and in contributing to bringing orders to the exchange floor for execution by the auction process. Congress recognized the existence of fixed commissions but chose neither to outlaw that practice nor to endorse it, but rather to bring it under the complete control of the Commission.

In so doing, Congress recognized that the exchanges were dynamic and changing institutions that should not be frozen into a static statutory mold. Rather, Congress chose to grant broad discretion and authority to the supervisory administrative agency—the Commission—to adapt the exchange mechanism to changing needs.

The Commission has recently concluded that the traditional exchange mechanism, including the rigid rate structure, has proved ill-suited to the needs of a changing market influenced by the rise of institutional investors and modern technology. In response to these developments, the Commission has been implementing over the last decade a major restructuring of the securities markets, including, as one of its constituent elements, the phasing out of fixed minimum commissions. This program, along with numerous other changes, is designed, among other things, to prevent the elimination of fixed commissions from having the disastrous consequences which are feared by many.

The fundamental error of the Department of Justice is that it views this case not as one involving a unique regulatory scheme for a market, but as merely another in a long line of cases concerning the application of the antitrust laws to regulated companies and public utilities. The Department would therefore make the decision in this case turn upon the presence or absence of a "pervasive scheme" of "public utility type" rate regulation. But the principles set forth in *Silver* and other decisions of this Court for the reconciliation of the unique scheme of regulation of the securities markets and the antitrust laws cannot be so simply avoided and displaced by resort to a factor which is largely irrelevant. What is relevant here is not the standards and procedures by which the Commission considers the reasonableness of a particular rate, but rather whether the plenary jurisdiction of the Commission over exchange practices such as rate fixing which significantly affect the structure and functioning of these vital markets shall be displaced and disrupted by *ad hoc* anti-

trust suits.[58] *Silver* compels a finding of implied repeal of the antitrust laws in this case, since application of the antitrust laws to exchange rules subject to Commission supervision and review would conflict with the Commission's jurisdiction and render ineffective the Exchange Act's regulatory scheme.

The wisdom of Congress' grant of exclusive jurisdiction to the Commission to regulate the nation's stock exchanges and securities markets is illustrated by the public record of Commission regulation of the fixed commission rate system. That record of Commission supervision and review—which involves formulation and implementation of Commission regulatory policies through both the formal and informal procedures contemplated by the Act—discloses the complex and subtle economic issues concerning the stock exchanges' rate systems, and substantiates the necessity for leaving the regulation of exchanges and markets to the continuing and exclusive jurisdiction of the Commission.

ARGUMENT

I. The Securities Exchange Act Established a Comprehensive Scheme of Regulation of Securities Markets in which the Securities and Exchange Commission is Vested with Jurisdiction to Engage in Continuous Regulation of all Important Matters Respecting Stock Exchanges Including the Fixing of Commission Rates.

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[58] As we point out (pp. 38-39 *infra*), a person aggrieved by Commission action with respect to exchange rules which may be anti-competitive is entitled to judicial review otherwise than by collateral attack in an antitrust court.

A close analysis of the regulatory scheme created by the Exchange Act and the proper application of the principles governing reconciliation of the Exchange Act with other statutory regimes enunciated by this Court in *Silver* v. *New York Stock Exchange, Inc.*, *supra*, 373 U.S. 341, and *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117, establish that, in order for that regulatory scheme to work, and thus for the congressional goals of the Act to be achieved, exchange conduct subject to the Commission's supervisory jurisdiction under the Act must be immunized from antitrust attack.

In *Silver* and *Ware*, as well as in other cases where the accommodation of the antitrust laws with a federal regulatory statute was to be resolved, this Court began the process of reconciliation with a searching inquiry into the genesis and aims of the federal regulatory act.[8] Thus, in order to resolve the issue of implied repeal of the antitrust laws presented in this case, we first examine the legislative history and framework of the Securities Exchange Act.

A. The Legislative History of the Act Evidences that Congress in 1934 Recognized that Securities Exchanges Possessed Anti-Competitive Features and Fashioned a Unique Scheme of Supervision by the Commission to Effect the Goals of the Act.

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[8] See, *e.g.*, *Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. 726, 732, 736-739; *Otter Tail Power Co.* v. *United States*, 410 U.S. 366, 373-74; *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213, 218-220; *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 350-352; *United States* v. *Radio Corporation of America*, 358 U.S. 334, 339-346.

The Exchange Act grants to the Commission broad jurisdiction to regulate the operations of the nation's securities markets. The legislative history of the Exchange Act clearly evidences that in granting this regulatory jurisdiction to the Commission, Congress intended the Commission to possess a number of regulatory tools, including supervisory authority over the regulation of stock exchange operations so that its policy-making functions would be complete and effective. One of the features of exchange operations of which Congress was specifically aware in formulating the Exchange Act and which was purposely brought within the scope of the scheme of Commission regulation under the Act was the exchanges' practice of fixing minimum rates of commission.

While Congress considered regulating stock exchanges on several occasions during the three decades prior to 1934,[7] the immediate impetus to the adoption of the Exchange Act was the disclosure of serious instances of irresponsibility displayed by exchange members during 1929 and the early thirties.[8] Early in his first administration President Franklin Roosevelt directed the formation of a committee, under the chairmanship of Daniel C. Roper, then Secretary of Commerce, to study regulation of stock exchanges.[9]

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[7] See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, *supra*, 414 U.S. at 128, n. 9; *see generally* R. De Bedts, *The New Deal's SEC; The Formative Years*, Ch. 1 (1964) [hereinafter cited as "*De Bedts*"].

[8] *De Bedts*, pp. 9-29.

[9] Letter from the President of the United States to the Chairman of the Senate Committee on Banking and Currency with an Accompanying Report Relative to Stock Exchange Regulation, 73d Cong., 2d Sess., p. iii (Committee Print) [hereinafter cited as "*Roper Report*"].

The report of this committee, the *Roper Report,* specified two major imperatives that should be adhered to in any scheme for federal regulation of the stock exchanges. The report first concluded that since stock exchanges "do not present a static situation susceptible to fixed standards" but rather present "a highly dynamic, ever changing picture, subject to untold and unknown possibilities and combinations that are today unpredictable," it would be inappropriate "to place this complex and important mechanism in a strait jacket." *Roper Report,* p. 6. Therefore, the committee stated, ". . . while certain provisions [to remedy abusive practices on the exchanges] might be included in any regulations, such provisions should not be the only power of correction left open to an administrative agency [regulating exchanges], but it should have broad discretion to operate directly on various abuses as the future may prove them to exist." *Id.*

The *Roper Report* further concluded, however, that it would be undesirable to "deprive" the exchanges "of initiative and responsibility" in dealing with their members. *Id.* at p. 8. Rather, in the opinion of the committee, it appeared "distinctly better" to hold an exchange "to a high degree of accountability for the conduct of members" in order to stimulate meaningful exchange regulation of its members.

Both of these imperatives were accorded recognition in the committee's recommendation for a system of federal licensing of securities exchanges whereby

> "all exchanges desiring a Federal license must adopt and submit to the proposed Stock Exchange

> Authority for its approval, rules designed to comply with the regulatory requirements outlined by the proposed statute and with such rules and regulations as may be promulgated by the proposed stock exchange authority thereunder. Furthermore, as a condition of retaining a license an exchange would be required to abide by and enforce such regulatory requirements and such rules and regulations. Any exchange would be permitted to adopt any other or additional rules and regulations not inconsistent with the regulatory requirements outlined by the statute or the rules and regulations promulgated by such proposed Stock Exchange Authority." *Roper Report,* p. 11.

Following publication of the *Roper Report,* legislation [10] was introduced in both the House and Senate,[11] which provided for the licensing and disciplining of securities exchanges, and vested broad discretionary authority in the regulatory agency over, in effect, the entire range of exchange operations (Doc. App. 1-8).[12] This grant of broad authority to the federal

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[10] For a description of the history of the drafting of the Exchange Act, see *De Bedts,* Ch. III.

[11] The Exchange Act was originally introduced as H.R. 7852, 73d Cong., 2d Sess. and S. 2693, 73d Cong., 2d Sess. Following extensive hearings, these bills were revised and reintroduced as H.R. 8720, 73d Cong., 2d Sess., H.R. 9323, 73d Cong., 2d Sess. and S. 3420, 73d Cong., 2d Sess. In amended form, H.R. 9323 and S. 3420 became the Securities Exchange Act.

[12] See H.R. 7852 and S. 2693, Sections 5 and 18(c); H.R. 8720, Sections 5 and 18. Pertinent sections of these bills, as well as other relevant publicly-available materials are set forth in the Documentary Appendix accompanying this brief. References to mate-

regulating agency contained in the early drafts of the legislation, received both support [13] and criticism [14] during the congressional hearings held on these bills. The principal criticism raised was that these bills would impose greater federal regulation of the exchanges than had been contemplated in the *Roper Report,* providing for what one critic characterized as "not regulation but domination." [15] In fact, the drafters of the legislation acknowledged that they had struck a different balance with respect to the extent the federal agency would be empowered to take the regulatory initiative than had the *Roper Report,*[16] since the bills would give the Commission power "to step in and prescribe the rules under which the exchange shall operate in practically all particulars . . . ." [17] This regulatory scheme was justified, it was argued, on the ground that it was

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rial contained in the Documentary Appendix are cited as ("Doc. App. ").

[13] See Hearings Before the Senate Committee on Banking and Currency on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.), 73d Cong., 1st and 2d Sess. [hereinafter cited as "Senate Hearings"], pp. 6868 (Statement of Herman Kinnicutt, member of Investment Bankers Association, New York, N.Y.), 7256 (Statement of A. Verle Shaw).

[14] See Hearing before the House Committee on Interstate and Foreign Commerce on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess. [hereinafter cited as "House Hearings"], p. 227 (Statement of Richard Whitney, President of the New York Stock Exchange); Senate Hearings, pp. 6638-39 (Statement of Richard Whitney, President of the New York Stock Exchange), 6901-6915 (Statement of Frank R. Hope, President of the Association of Stock Exchange Firms).

[15] See Senate Hearings, pp. 6638-39; House Hearings, p. 227.

[16] See House Hearings, pp. 26-27 (Statement of Hon. H. M. Landis, Commissioner, Federal Trade Commission).

[17] Senate Hearings, p. 6566 (Statement of Thomas G. Corcoran).

necessary to empower the Commission to step in, in the event the Commission finds the method of operation being undertaken by the exchange unsatisfactory to it and to this end the Commission should have a power of intervention short of revoking an exchange's license.[18]

It was in this context—a debate on the proper balance that ought to be struck—that the Congress specifically focused on the fact that the stock exchanges had anti-competitive features and that any federal regulation of the exchanges should involve regulation of these features, including in particular, the exchanges' practices of fixing minimum commission rates. Thus, the practice of fixing minimum commission rates was described in the congressional hearings,[19] and the ap-

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[18] Senate Hearings, pp. 6566-6570 (Statement of Thomas G. Corcoran).

[19] See Senate Hearings, pp. 6075, 6080; House Hearings, pp. 320-321, 423.

The practice of fixing commission rates on stock exchanges in the United States is generally traced back to the so-called Buttonwood Tree Agreement of 1792. *See* Eames, The New York Stock Exchange, p. 14 (1894).

In 1912 and 1913, a subcommittee of the House Committee on Banking and Currency, 62d Congress, made an extensive investigation of stock exchange operations. The resulting report of this committee—H.R. Rep. No. 1593, 62d Cong., 3d Sess., known as the *Pujo Report* after the Chairman of the subcommittee—specifically dealt with the NYSE's practice of commission rate fixing, noting that:

> "The rule is rigidly enforced by suspension from one to five years for a first violation and expulsion for a second. . . . The acknowledged object is to prevent competition amongst the members."

Pujo Report, p. 39. The *Pujo Report* advised against any congressional action proscribing this practice because, *inter alia*, the subcommittee believed

propriateness of federal regulation of the exchanges' fixed rate system was the subject of discussion during those hearings.[20] For example, one of the leading authorities of the time on stock exchange operations,

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"the present rates to be reasonable, except as to stocks, say, of $25 or less in value, and that *the exchange should be protected* in this respect . . . *against a kind of competition between members that would lower the service and threaten the responsibility of members. A very low or competitive commission rate would also promote speculation and destroy the value of membership.*"

Pujo Report, pp. 115-116 (emphasis added).

The conventional wisdom concerning the propriety of the fixed commission rate system was the same at the time of the enactment of the Securities Exchange Act. Thus, a comprehensive study of the operations of the exchange market published in 1935 made the following observation with respect to the fixed rate system:

"Among the provisions [of the NYSE's rules and constitution] specifically regulating the brokers in their relations with each other, there is the requirement of *minimum commission charges. This serves the double purpose of making unfair competition among brokers punishable and of providing better and cheaper service to the public.* The prohibition against splitting commissions has served to do away, in part at least, with unnecessary middlemen who are beyond the control of the Exchange. It has also kept the larger part of the brokerage business in the hands of the brokers rather than permitting it to drift into the hands of banks."

The Twentieth Century Fund, Inc., *The Security Markets*, p. 226 (1935) (emphasis added).

An earlier publication of the Twentieth Century Fund's findings, Twentieth Century Fund, *Stock Market Control* (1934), was repeatedly relied upon in the drafting and consideration of the Securities Exchange Act. See, *e.g.*, Senate Hearings, p. 6467; 78 Cong. Rec. 8031-8032 (remarks of Mr. Pettengill), 8180 (remarks of Senator Fletcher), 8395 (remarks of Senator Barkley).

[20] *Compare* Senate Hearings, p. 6868 (where the witness recommended against giving the federal regulatory agency "control over commission charges" on the ground that such control "must be left as [a matter] of self-preservation to the exchanges and their members") *with id.*, p. 7705.

Samuel Untermeyer, who was chief counsel to the Congressional committee which wrote the *Pujo Report* (discussed note 19 *supra*) made the following recommendations with respect to stock exchange rate fixing:

> "While section . . . [18] of your bill [S. 2693] would give the . . . Commission the right to prescribe uniform rates of commission, it does not otherwise authorize the Commission to fix rates, which it seems to me it should do and would do by striking out the word 'uniform.' *That would permit the Commission to fix rates.*
>
> "The volume of the business transacted on the exchange has increased manyfold. Great fortunes have been made by brokers through this monopoly. The public has no access to the exchange by way of membership except by buying a seat and paying a very large sum for it. Therefore it is a monopoly. Probably it has to be something of a monopoly. But after all it is essentially a public institution. It is the greatest financial agency in the world, and should be not only controlled by the public but *it seems to me its membership and the commission charged should either be fixed by some governmental authority or be supervised by such authority.* As matters now stand the exchange can charge all that the traffic will bear, and that is a burden upon commerce."

Senate Hearings, p. 7705 (emphasis added). The bill as enacted deleted the word "uniform" as Mr. Untermeyer suggested, and substituted the word "reasona-

ble." *See,* H.R. Rep. 1838, 73d Cong., 2d Sess., p. 19 (Conference Report).

The original bills were revised in response to the criticisms and suggestions made in the hearings so that the legislation, as reported out of the respective House and Senate committees,[21] struck a balance somewhat more akin to the position expressed in the *Roper Report* than was the position contained in the initial version of the bills by leaving with the exchanges in the first instance the responsibility to establish rules governing their operations but nevertheless subjecting the exchanges to the continuous authority of a federal regulatory agency.[22]

Nevertheless, Congress emphasized that this grant of self-regulatory responsibility was to be subject to the continuous plenary jurisdiction of the Commission. As the House report explained, "the bill gives the Commission broad powers over the exchanges to insure their efficient and honest functioning" because as economic forces affecting speculation converge "upon the exchanges, the control of the exchange mechanism is a necessary part of any effective regulation." H.R. Rep. 1383, *supra,* at p. 14.[22] To aid these powers, exchanges seeking registration were required to agree that they would continuously furnish "the

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[21] H.R. 9323, 73d Cong., 2d Sess. and S. 3420, 73d Cong., 2d Sess.

[22] One of the basic purposes of the Exchange Act was the establishment of "an efficient, adequate, open and free market for the purchase and sale of securities. . . ." (78 Cong. Rec. 8162 (remarks of Senator Fletcher)) and control of the exchange mechanism was regarded as essential to achieving that purpose. See 78 Cong. Rec. 7862 (remarks of Mr. Lea), 7864 (remarks of Mr. Wolverton), 8161, 8163 (remarks of Senator Fletcher).

Commission with complete information concerning [their] . . . organization, membership, and rules." S. Rep. No. 792, 73d Cong, 2d Sess., p. 15. And, as the House Report further explained, "if the rules of the exchange in *any important matter* are not appropriate to insure fair dealing, [the Commission is empowered] to order such changes in the rules after due notice and hearings, as it may deem necessary." H.R. Rep. No. 1383, *supra,* at p. 15 (emphasis added).

The sponsors of the legislation pointed out that it was necessary throughout the bill to vest "broad discretionary powers" in the Commission because of the "complicated nature of the problems" dealt with in the bill, and because the bill regulated a "field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means." H.R. Rep. No. 1383, *supra,* at pp. 6-7. And the powers specifically granted the Commission over exchange rules were characterized as "quasi-legislative." [23]

The floor debates on H.R. 9323 and S. 3420 focused on the nature and consequences of the broad supervisory power that these bills would, if enacted, grant the Commission over the exchanges' rules. In the House, concern centered around what is now Section 19(b) of the Act (then Section 18(b), H.R. 9323), which empowered the Commission to act by rulemaking to amend or alter the rules of an exchange, and the fact that the bill did not provide for direct appellate review of such Commission action. 78 Cong. Rec.

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[23] 78 Cong. Rec. 8091 (remarks of Mr. Lea); see also 78 Cong. Rec. 7696 (remarks of Mr. Rayburn), 7862 (remarks of Mr. Lea).

8087-8093. In arguing that a procedure should have been provided for judicial review of Commission action altering or amending exchange rules, certain members of the House stressed, among other things, that the bill as drafted gave the Commission unreviewable authority to fix commission rates at levels which could, for example, be set so low as to put exchange members out of business.[24]

During debate in the Senate, the bill was criticized as granting the Commission authority over exchanges that exceeded that necessary to achieve what some Senators perceived as the bill's underlying purpose of curbing dishonest and economically harmful manipulative and speculative practices in connection with trading in securities.[25] An amendment was offered by Senator Hastings of Delaware on the Senate floor to what is now Section 19(b) of the Exchange Act, that would have struck from that section of the bill the enumerated matters presently subject to the Commission's jurisdiction under Section 19(b), and instead would have limited the Commission, by order, to alter or supplement the rules of an exchange to prevent "excessive credit for speculation and . . . unfair practices on stock exchanges." 78 Cong. Rec. 8592. Senator Hastings explained that in his view Section 19(b) went too far in empowering the Commission "to regulate the internal operations of exchanges in many matters which do not bear, either directly or even remotely

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[24] See 78 Cong. Rec. 8091 (remarks of Mr. Pettengill and Mr. Wadsworth), 8092 (remarks of Mr. Dondero).

[25] See 78 Cong. Rec. 8283 (remarks of Senator Walcott), 8591-92 (remarks of Senators Hastings and Copeland).

upon the control of credit or unfair practices in the purchase and sale of securities." 78 Cong. Rec. 8592. One of the matters of internal operations specifically pointed to was the fixing of commission rates.[26] *Id.*

In support of the Hastings amendment, Senator Copeland of New York argued that "the brokerage business is not a public utility" and therefore that it would be inappropriate to regulate the exchanges like a public utility through the fixing of commission rates. *Id.* Because of a "determination" in the Congress "to turn over the stock exchange and its whole operation to a commission of the Federal Government," Senator Hastings predicted that the amendment would not be adopted and, in fact, the amendment was rejected. *Id.*

While various provisions of the legislation were modified in some respects prior to passage of the Act,[27] the basic regulatory scheme described above was enacted.

In view of the foregoing discussion, we fail to understand how the Department of Justice [28] can contend that

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[26] Similarly, Senator Hastings had previously observed during the floor debates that

"there is the distinct and definite provision that the proposed commission may fix the rates of commission which the stock exchange members may charge for the services they render. They cannot by rule and regulation govern it any longer. They cannot by rule and regulation fix it at an amount which they believe will return to them a fair amount of money annually, or that will increase their business. They may not use their judgment about it any longer. It passes to the commission." 78 Cong. Rec. 8490.

[27] See, *e.g.*, H.R. Rep. 1838, *supra*, at p. 37.

[28] References to pages of the Brief for the United States As Amicus Curiae, which has been filed by the Solicitor General on

Mr. Untermeyer's testimony was the "only reference to fixed commission rates of any significance" in the legislative history of the Exchange Act (DOJ Br. 30) and that there is "nothing in the history . . . [of the Exchange Act that] reflects a purpose by Congress to endorse" the practice of fixing minimum commission rates (DOJ Br. 53). The legislative history, as the court below noted (451a), clearly reveals that Congress in 1934 viewed the fixed rate practice as a "keystone" of the exchanges' organization. Moreover, there is further exhibited in the Exchange Act's history the deliberate determination by the Congress not to leave unregulated the anti-competitive aspects of exchange operations, but rather to subject all important matters, including the practice of exchange rate-fixing, to the jurisdiction of the Commission. Thus, Congress adopted Mr. Untermeyer's recommendation to provide the Commission with plenary authority over the exchange's anti-competitive practice of fixing rates (see pp. 21-22, *supra*). And it did so in the context of the apparent endorsement of the exchanges' rate fixing practices by the Pujo Committee, to which Mr. Untermeyer was chief counsel, and in the context of the conventional wisdom in 1934 that such practices were desirable.[29] In addition, in rejecting the Hastings amendment, (see pp. 24-25, *supra*), Congress manifested its intention that the authority granted to the Commission in Section 19(b) to alter or supplement ex-

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behalf of the Department of Justice, are cited as "DOJ Br. . . . ." Arguments set forth in that brief are referred to as those of "the Department of Justice."

[29] See note 19 *supra*.

change rules, where "such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange," should go beyond the mere prevention of fraudulent and manipulative practices on the exchanges and should authorize the Commission to supervise the exchange mechanism with respect to all important matters—including the fixing of commission rates.[30]

The conclusion drawn from the Exchange Act's history, that Congress intended to superimpose a scheme of regulation over entities it knew to have anti-competitive features, is in no way mitigated by amendments to the Exchange Act in 1936 and 1938, as the Department of Justice asserts (DOJ Br. 32-35). Thus, while the 74th Congress in 1936 did amend the Exchange Act by adding Section 12(f) to the Act, 15 U.S.C. 78l(f), to permit trading of unlisted securities on exchanges and thereby "create a fair field of competition among exchanges and between exchanges as a group and the over-the-counter markets" (S. Rep. No. 1739, 74th Cong., 2d Sess., p. 3), Congress specifically

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[30] The Department of Justice appears to have abandoned its essentially unsupported assertion advanced in the court below that the power of the Commission in Section 19(b)(9) was intended to be limited solely to setting maximum commission rates in order to protect investors from exhorbitant charges. Brief for the United States as Amicus Curiae, *Gordon* v. *New York Stock Exchange*, C.A. 2, No. 74-1043, at p. 26. Certainly, in view of the exchanges' practice of fixing minimum commission rates, dating back to 1792, an intention to exclude fixed *minimum* commissions from the Commission's supervisory jurisdiction would have been expressed in clear and unequivocal terms.

explained that the purpose of the amendment was "to allow each type of market to develop in accordance with its natural genius and consistently with the public interest." *Id.* This reference to the "natural genius" of each type of market reflects Congress' awareness of the distinction between the competitive over-the-counter market on the one hand and the exchange markets which it had subjected to regulation in 1934.

Congress' awareness of this distinction is more clearly revealed in connection with the 1938 Maloney Act Amendments to the Exchange Act which, contrary to the Department of Justice's contentions, do not support the view that Congress intended the antitrust laws to apply to exchange practices subject to the Commission's jurisdiction (DOJ Br. 35). The Maloney Act provided for self-regulation of the over-the-counter market through the establishment of associations of over-the-counter market dealers—associations not yet in existence when the Act was passed. In creating this regulatory scheme, Congress recognized that self-regulatory associations could have an anti-competitive effect on the then existing "free and open" nature of the over-the-counter market. H.R. Rep. No. 2307, 75th Cong., 3d Sess., p. 8. The proponents of the Maloney Act noted that, in contrast to the over-the-counter market, stock exchanges "had certain features that may be regarded as monopolistic because of their exclusive nature," and explained that the Exchange Act represented "an attempt to bring those practices under control." Hearings before the Senate Committee on Banking and Currency on S. 3255, 75th Cong., 3d Sess., p. 7. Since the over-the-counter market lacked any

anti-competitive aspects, Congress made clear in the Maloney Act that the activities of registered associations were "to be consistent with the operation of free and open markets." H.R. Rep. No. 2307, *supra,* at p. 8. But the Exchange Act did not attempt to turn stock exchanges into free and open markets; rather it sanctioned the anti-competitive features of the exchange markets subject to the Commission's jurisdiction.

Finally, the Department of Justice refers to the enactment by Congress in 1934 of the Communications Act which provided an express antitrust exemption for telephone company mergers approved by the Federal Communications Commission (DOJ Br. 31, n.17). It is contended that the inclusion of this express exemption in that act, which was being considered about the same time as the Exchange Act, compels the conclusion that the absence of an express exemption in the Exchange Act requires application of the antitrust laws to matters subject to the Commission's jurisdiction under Section 19(b). But, as the Department of Justice itself has asserted (DOJ Br. 47-48), it is likely that Congress in 1934 did not think that the Sherman Act applied to exchange practices, and thus would have had no reason to provide for an express exemption. Also unfounded is the alternative assertion that, because Congress did not expressly consider the antitrust laws when formulating the Exchange Act, this Court cannot now find an implied repeal of those laws with respect to matters subject to the Commission's jurisdiction. The existence of antitrust immunity is not dependent upon whether Congress specifically intended to exempt exchange practices subject to Com-

mission jurisdiction from antitrust attack. Indeed, if as the Department of Justice asserts (DOJ Br. 47), the question of implied repeal depends simply on finding a conscious congressional intention to exempt regulated activity from the antitrust laws, it is difficult to understand why this Court has on so many occasions engaged in exhaustive analyses of other regulatory schemes in determining whether to find an implied repeal. See *Georgia* v. *Pennsylvania R.R. Co.*, 324 U.S. 439; *United States* v. *Radio Corporation of America*, 358 U.S. 334; *California* v. *Federal Power Commission*, 369 U.S. 482; *Pan American World Airways, Inc.* v. *United States*, 371 U.S. 296; *United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321; *Carnation Co.* v. *Pacific Westbound Conference*, 383 U.S. 213; *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 237; *Otter Tail Power Co.* v. *United States*, 410 U.S. 366. As we shall show *infra*, implied repeal of the antitrust laws arises here because the statutory scheme in the Exchange Act simply will not work as Congress intended if exchange conduct subject to the Commission's jurisdiction may be challenged under the antitrust laws.

B. The Exchange Act on Its Face Confers Jurisdiction on the Commission to Regulate Stock Exchanges With Respect to all Important Matters.

The Commission was given responsibilities under the Exchange Act with respect to numerous activities affecting securities markets. Thus the Commission is empowered to define and prohibit such matters as manipulation and deceptive practices (see Sections 9 and 10 of the Act, 15 U.S.C. 78i and 78j); to require

brokers and dealers to meet adequate financial standards (see Sections 8 and 15(c)(3) of the Act, 15 U.S.C. 78h and 78o(c)(3)); to set standards for the utilization of exchange membership; and to regulate exchange specialists and floor traders (see Section 11 of the Act, 15 U.S.C. 78k). Further to implement the Commission's regulation of exchanges, Congress also provided in Section 6 of the Act, 15 U.S.C. 78f, for the registration of securities exchanges with the Commission.[21] Section 6(a), 15 U.S.C. 78f(a), provides, as a prerequisite to registration, that the registration statement filed by the exchange contain, *inter alia,* "[a]n agreement . . . to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of" the Exchange Act and the Commission's rules and regulations thereunder. Furthermore, under Section 6(d), 15 U.S.C. 78f(d), the Commission, before granting an application for registration, must find that an exchange is "so organized as to be able to comply with the provisions of" the Act and that its rules "are just and adequate to insure fair dealing and to protect investors."

Congress next provided, through Section 19(a) of the Act, 15 U.S.C. 78s(a), that the Commission be vested with jurisdiction to assure compliance by registered exchanges with their duties under the Act. Section 19(a)(1), 15 U.S.C. 78s(a)(1), authorizes the Commission to discipline an exchange within specified limits for violating the Act or any rules thereunder, or

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[21] Section 5 of the Act, 15 U.S.C. 78e, makes it unlawful, except in certain cases not relevant here, to effect any securities transaction on an unregistered exchange.

for failing "to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon."[33] And pursuant to Section 19(a)(2), 15 U.S.C. 78s(a)(2), the Commission may discipline members and officers of registered exchanges.

Finally, and most important, in Section 19(b) of the Act Congress conferred plenary powers upon the Commission to supervise and oversee the nature and structure of particular exchanges and exchanges generally. Under Section 19(b), if the Commission, after following prescribed procedures, determines that changes in an exchange's rules are

> "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange [it may] by rules or regulations or by order . . . alter or supplement the rules of such exchange"

with respect to "such matters as" twelve broadly enumerated subjects and "similar matters." One of the matters *specifically* enumerated—in Section 19(b)(9)

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[33] The Commission has, pursuant to Section 19(a)(1), withdrawn the registration of a national securities exchange which, among other things, violated the Exchange Act and failed to enforce compliance with the Act and with the exchange's own rules by members and issuers of listed securities. *San Francisco Mining Exchange*, Securities Exchange Act Release No. 7870 (1966), [1966-1967 Transfer Binder] CCH Fed. Sec. L. Rep. ¶77,343, *affirmed sub. nom. San Francisco Mining Exchange* v. *Securities and Exchange Commission*, 278 F. 2d 162 (C.A. 9).

—is "the fixing of reasonable rates of commission. . . ."[33]

The procedures prescribed in Section 19(b) that are to be followed in effecting changes in exchange rules relating to rates of commission, have been aptly summarized as follows:

> "The first step is that an exchange adopts rules fixing rates of commission. If changes are deemed necessary or appropriate, the Commission is to present an appropriate request in writing for specified changes. Compliance by the exchange presumably ends the matter, but if the exchange does not accede, the Commission is empowered, after appropriate notice and opportunity for hearing, 'by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) . . .'"[34]

In order to supplement its Section 19(b) authority to regulate the rules of registered securities exchanges

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[33] Congress' inclusion of rate-fixing in Section 19(b)(9) is consistent with another indicium of Congress' intent to fashion Commission regulation of exchanges around their essentially anti-competitive practices. Thus, Section 3(a)(3) of the Act defines an exchange member as

> "any person who is permitted either to effect transactions on the exchange without the services of another person acting as broker, or to make use of the facilities of an exchange for transactions thereon without payment of a commission or fee or with payment of a commission or fee which is less than that charged the general public. . . ."

[34] Securities and Exchange Commission, *Special Study of Securities Markets*, Pt. 2, p. 344 (1963), H. Doc. No. 95, 88th Cong., 1st Sess.

and because that authority would be fostered by affording "an opportunity for orderly Commission consideration of exchange rules before they become effective," the Commission in 1964 promulgated Rule 17a-8, 17 C.F.R. 240.17a-8, pursuant to Section 17(a) of the Exchange Act, 15 U.S.C. 78q(a), which requires regulated entities to file reports. See Securities Exchange Act Release No. 7253 (1964). The Rule requires an exchange to file with the Commission "copies of . . . any proposed amendment or repeal of, or any addition to, its rules not less than three weeks . . . before any action is taken [by the exchange to adopt] . . . such amendment."

It can therefore be seen that the Exchange Act contemplates Commission supervision of exchange self-regulation through a process having both formal and informal aspects. Thus, the procedure set forth in Section 19(b), which authorizes the Commission to present a written request to an exchange to effect changes in its rules, as well as the procedure set forth in Rule 17a-8, affording the Commission an opportunity to examine proposed rule changes prior to their adoption, results in continuous Commission participation in the process of formulating exchange rules and amendments to exchange rules *without* the institution of a formal rulemaking or adjudicatory proceeding pursuant to Section 19(b).[35] In this process the Commission necessarily exercises its statutory mandate to insure that the exchange's rules are consistent with

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[35] The Commission's authority is further supplemented by its power to conduct public investigatory hearings pursuant to Section 21(a), 15 U.S.C. 78u(a).

the purposes of the Act. This is precisely the way in which Congress desired the "partnership between government and private enterprise that marks the design of the . . . Exchange Act . . ." to operate. *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 366.

It is also evident that, commencing from the initial stage of registration of an exchange with the Commission, the necessity and propriety of exchange rules regarding the matters enumerated in Section 19(b), including the fixing of commission rates, are subject to the continuous jurisdiction of the Commission. And while

> "the promulgation of rules concerning exchange-required fixed commission rates is a matter that Congress entrusted to the exchanges in the first instance." [36]

any exchange's action affecting its commission rate structure is also a matter which must comport with Commission policy.

Under the public interest standard in Section 19(b), the Commission has for over three decades recognized that the national policy favoring competition is a highly relevant factor in determining whether rules of an exchange are "necessary or appropriate." [37] Furthermore, the standard governing the Commission's

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[36] Securities Exchange Act Release No. 10560 (1973), CCH Fed. Sec. L. Rep. ¶79,603 at p. 83,620.

[37] See, *e.g., In the Matter of the Rules of the New York Stock Exchange,* 10 SEC 270, 287; Securities Exchange Act Release No. 8234 (January 26, 1968); Securities Exchange Act Release No. 9950 at pp. 169-70 (January 26, 1973) [185 BNA Sec. Reg. and

actions under Section 6(d) of the Act in ordering effective an exchange's registration involves the same public interest test found in Section 19(b) and therefore, contrary to the view of the Department of Justice (DOJ Br. 42), also requires Commission consideration of competitive factors.

Indeed, in the Commission's most recent public proceeding involving the registration of a national securities exchange—the Chicago Board Options Exchange [38] —under Section 6, the Antitrust Division of the Department of Justice was an active participant in the Commission's proceeding and urged that "it would be plainly contrary to the broad public interest in a competitive economy" for the Commission to permit the Chicago Board Options Exchange to have a fixed minimum commission rate system.[39] The Commission did in fact consider competitive factors in determining to order effective the Chicago Board Options Exchange's rules.[40]

L. Rep. (January 17, 1973)]. In *Silver* v. *New York Stock Exchange, supra,* 373 U.S. at 364, n.16, this Court stated that an exchange rule adopted at the direction of the Commission pursuant to Section 19(b) would have to be "consonant with the antitrust laws." See also *Bowman* v. *Arkansas-Best Freight System, Inc.*, 95 S. Ct. 438, 448; *Gulf States Utilities* v. *Federal Power Commission*, 411 U.S. 747; *Federal Maritime Commission* v. *Seatrain Lines, Inc., supra,* 411 U.S. 726.

[38] See *Chicago Board Options Exchange, Inc.*, Securities Exchange Act Release No. 9985 (February 1, 1973), CCH Fed. Sec. L. Rep. ¶79,212 at p. 82,669.

[39] See Comments of the United States Department of Justice, Proposed Rules of the Chicago Board Options Exchange, Securities and Exchange Commission File No. 10-54-1 (January 15, 1973), p. 4. (Doc. App. 162, 165).

[40] See *Chicago Board Options Exchange, Inc.*, Securities Exchange Act Release No. 9985, *supra,* CCH Fed. Sec. L. Rep. ¶79,212 at p. 82,671.

However, competition is not the sole factor the Commission must consider in regulating exchange rules. The scheme of regulation in the Exchange Act is the "frame of reference within which the Commission operates; and the policy expressed in [that Act] must be the basic determinant of its action." [41] Accordingly, along with the national policy favoring competition, the Commission must also be concerned with such questions as the liquidity of the exchange markets, the ability of the brokerage industry to raise capital for industry and to provide efficient and effective service to investors.[42]

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[41] *McLean Trucking Co.* v. *United States*, 321 U.S. 67, 79-80, 85-88 (Interstate Commerce Commission); *Bowman* v. *Arkansas Best Freight System, Inc., supra*, 95 S. Ct. at 448; *cf., California Gas Producers Association* v. *Federal Power Commission*, 421 F. 2d 422, 428-29 (C.A. 9), *certiorari denied*, 400 U.S. 819; *City of Statesville* v. *Atomic Energy Commission*, 441 F. 2d 962, 987 (C.A. D.C.) (Leventhal J., concurring); *Northern Natural Gas Co.* v. *Federal Power Commission*, 399 F. 2d 953, 961 (C.A. D.C.). The legislative history of the Exchange Act suggests that Congress intended that the Commission, in exercising its Section 19(b) authority over exchanges, look to the policies of the Act generally for a standard. See 78 Cong. Rec. 8091 (remarks of Mr. Lea).

[42] Recognition of the need to balance these competing policy considerations has motivated the congressional committees' studying the securities industry's rate structure to endorse the Commission's program for a phased elimination of fixed rates. See *Regulation of Securities Trading by Members of National Securities Exchanges and the Sale of Investment Advisers of Registered Investment Companies, A Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 470*, Sen. Doc. No. 93-187, 93d Cong., 1st Sess., at 3 (1973); *Report of the Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, Securities Industry Study*, 93d Cong. 1st Sess. (February 1, 1973) at 62. See also Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3169, 92d Cong., 2d Sess., pp. 8, 11, 14 (Testimony of William J. Casey, Chairman, Securities and Exchange Commission).

Thus, to the extent that changes in an exchange's rules, including modification of the commission rate structure of an exchange, may affect the ability of the exchange to operate, the Commission must weigh the continued viability of the exchanges against a policy considering competition alone. Commission consideration of these factors has been most recently illustrated in the Commission's adoption of Rule 19b-3, 17 CFR 19b-3, which prohibits the fixing of commission rates by exchanges after certain dates.[42]

The Commission's continuing jurisdiction to supervise exchange rules and practices with respect to the matters enumerated in Section 19(b) and the fact that the Commission weighs the national policy favoring competition in its administration of its mandate to supervise exchange rules and practice demonstrates that Congress intended the Commission's jurisdiction over the matters enumerated in Section 19(b) to perform the "antitrust function."[43]

Moreover, as the court of appeals recognized (451a; 448 F. 2d at 1311), implied repeal of the antitrust laws does not preclude a sufficiently-aggrieved person from challenging exchange rules which may be anti-competitive.[44]

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[42] See Securities Exchange Act Release No. 11203 (January 23, 1975); see also pp. 75-80, *infra*.

[43] *Silver* v. *New York Stock Exchange*, *supra*, 373 U.S. at 358; see also *Kaplan* v. *Lehman Brothers*, 389 U.S. 954, 956 (Warren, C. J., dissenting from denial of certiorari); *Ricci* v. *Chicago Mercantile Exchange*, 409 U.S. 289, 302, n.13.

[44] Appropriate judicial review is not by way of collateral attack on exchange rules maintained under Commission supervision, but rather through direct judicial review of Commission action with respect to the exercise of its supervisory responsibility. The

II. Application of the Antitrust Laws to Exchange Conduct Subject To Commission Jurisdiction Would Be Repugnant to the Scheme of Regulation Established By the Exchange Act.

A. Silver and Ware Require a Determination in the First Instance of Whether the Exchange Act's Regulatory Scheme Will Work if Antitrust Laws Are Applied To Exchange Activity Subject To Commission Jurisdiction Under Section 19(b).

With the framework and goals of the Exchange Act presented, it is now appropriate to consider "the principles of stock exchange pre-emption delineated" [46] by this Court in *Silver* v. *New York Stock Exchange, Inc., supra,* 373 U.S. 341, and *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware, supra,* 414 U.S. 117.

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judicial check on Commission action is afforded by the fact that Commission orders promulgated under Sections 6 and 19(b) are reviewable in a court of appeals pursuant to Section 25(a) of the Act, 15 U.S.C. 78j(a). And, Commission rules adopted under Section 19(b), as well as informal exercises of the Commission's supervisory authority, such as a determination not to object to the adoption of a proposed rule, have been held to involve "agency action" which, under appropriate circumstances, is reviewable in a district court. *See Independent Broker-Dealers' Trade Association* v. *Securities and Exchange Commission* 442 F.2d 132, 141-143, *certiorari denied,* 404 U.S. 482; *cf., PBW Stock Exchange, Inc.* v. *Securities and Exchange Commission,* 485 F.2d 718, 726, 733 (C.A. 3), *certiorari denied,* 416 U.S. 964. *See generally* Sections 4(d), 10(a) and 10(d) of the Administrative Procedure Act, 5 U.S.C. 553(e), 702(a), (d). Thus, it cannot be said that implied repeal of the antitrust laws in this area would leave the Commission with unreviewable authority over exchange rules.

[46] *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware, supra,* 414 U.S. at 125.

In *Silver*, the petitioners, who were not members of the NYSE, brought an action under the Sherman Act alleging that the NYSE "conspired with its member firms to deprive petitioners of their private wire connections and stock ticker service" provided to them by members of the NYSE. 373 U.S. at 345. This Court initially noted that since the NYSE's action, in causing member firms to disconnect petitioners' wire connections and stock ticker, constituted a group boycott, "absent any justification derived from the policy of another statute or otherwise, the Exchange acted in violation of the Sherman Act." *Id.* at 347-349. Because the NYSE had taken action under color of enforcing "its rules governing members' transactions and relationships with non-members," purportedly "germane to performance of . . . [its] duty" of self-regulation embodied in the Exchange Act (*id.* at 356), the existence of a *prima facie* violation of the antitrust laws was found by the Court to be only "the beginning, not the end, of inquiry." *Id.* at 349. As this Court stated, the "antitrust aim of eliminating restraints on competition" must be reconciled "with the effective operation of a public policy [embodied in the Exchange Act] contemplating that securities exchanges will engage in self-regulation which may well have anti-competitive effects in general and in specific applications." *Id.*

In effecting this reconciliation between the public policy of the Exchange Act and the aims of the antitrust laws, this Court enunciated the "guiding principle" that, since the Exchange Act "contains no express exemption of the antitrust laws," and since

"'[i]t is a cardinal principle of construction that repeals by implication are not favored,'" an implied repeal would be found "only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary." *Id.* at 357. This Court then distinguished between two aspects of the self-regulatory scheme embodied in the Exchange Act: those self-regulatory activities of registered exchanges over which the Commission has jurisdiction; and those self-regulatory activities which are not within the Commission's jurisdiction. *Id.* In this regard, the Court observed that while the Commission has the "power to request exchanges to make changes in their rules" and "to disapprove any rules adopted by an exchange," it does not have "jurisdiction to review particular instances of enforcement of exchange rules." 373 U.S. at 357. Accordingly, the particular exchange action before this Court in *Silver* was believed by the Court not to be subject to the Commission's jurisdiction and therefore the question of reconciliation in that case did "not involve any problem of conflict or coextensiveness of coverage with the agency's regulatory power." *Id.* at 358.

This Court further observed that the Exchange Act contains no "form of review of exchange self-policing" as to its rules and therefore "[t]here is nothing built into the regulatory scheme which performs the *antitrust function* of insuring that an exchange will not in some cases apply its rules so as to do injury to competition which cannot be justified as furthering legitimate self-regulative ends." *Id.* at 358-359 (emphasis added). Furthermore, this Court ruled that ap-

plication of the antitrust laws to *particular instances of exchange enforcement* of exchange rules was "not at all incompatible with the fulfillment of the aims of the Securities Exchange Act," since "under the aegis of the rule of reason, traditional antitrust concepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate" of the Act. *Id.* at 359-360. This Court stated:

> "Applicability of the antitrust laws, therefore, [rested in *Silver*] on the need for vindication of their positive aim of insuring competitive freedom. Denial of their applicability [to the *Silver* facts] would defeat the congressional policy reflected in the antitrust laws *without serving the policy of the Securities Exchange Act. Should review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented.*"

Id. at 360 (emphasis added).[47]

In *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware, supra,* 414 U.S. 117 this Court recently reaffirmed and elaborated upon the principles of stock exchange pre-emption expressed in *Silver.* In *Ware,* this

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[47] Finally, this Court concluded that the manner in which the NYSE and its members acted to disconnect the wire connections and stock ticker service to petitioners deprived the petitioners of such basic procedural safeguards that "the Exchange [had] . . . not even reached the threshold of justification under [the Exchange Act] . . . for what would otherwise be an antitrust violation." The Court therefore sustained the petitioners' antitrust challenge. 373 U.S. at 361-365.

Court considered whether a NYSE rule requiring arbitration of controversies arising out of the termination by an individual of his employment with an exchange member pre-empted California state law which afforded an employee the right to litigate wage disputes arising out of his employment. In its analysis, this Court stressed that the Exchange Act established a scheme of supervised self-regulation in which the Commission is provided with "direct supervisory" authority over exchange regulation and exchange rules relating to "12 designated subject areas and 'similar matters'" enumerated in Section 19(b). *Id.* at 129-30.[48] These matters, this Court reasoned, are germane to "the congressional aim in supervised self-regulation . . . to insure fair dealing and [the] . . . protection of investors from harmful or unfair trading practices" (*id.* at 130), and "[a]s a consequence, some exchange rules [*i.e.*, those not within the scope of Section 19(b)] are not subject to direct Commission scrutiny." *Id.* at 129.[49] Such an exchange rule which is not "directly

[48] In addition to its Section 19(b) authority, it was also noted in *Ware* that the Commission is given rulemaking authority in a number of other sections of the Act to promulgate rules which will affect the conduct of exchange members. 414 U.S. at 129, n. 10. See Sections 8, 9, 10, 11, 14 and 17 of the Exchange Act, 15 U.S.C. 78h, 78i, 78j, 78k, 78n and 78q.

[49] Indeed, the Commission urged this position in *Ware* in its brief *amicus curiae* to this Court where it stated at pages 11-12:

"Exchange rules that are not substantially related to the statutory objectives should not be considered paramount to otherwise conflicting statutes. Compare *Silver* v. *New York Stock Exchange*, 373 U.S. 341. Rule 347(b), as applied here, cannot be said to be related to the regulatory objectives of the statute in any but the most indirect manrer, and therefore it is not the type of exchange self-regulation within the scope and purposes

related to the Act's purposes" because it is not "designed to insure fair dealing and to protect investors," this Court stated, "would not appear to fall under the shadow of the federal umbrella [of stock exchange pre-emption]; it is instead, subject to applicable state law." *Id.* at 131.[50]

Unlike the instant case, where the challenged conduct—the fixing of minimum rates of commission—is directly within the scope of the Commission's regulatory authority under Section 19(b), the self-regulatory conduct at issue in both *Silver* and *Ware* was considered as not subject to the supervisory jurisdiction of the Commission. This Court explained in *Silver,* however, that the antitrust laws are repealed to the extent necessary to make the Exchange Act work and stated that "[s]hould review of exchange self-regulation be provided through a vehicle other than the antitrust laws, a different case as to antitrust exemption would be presented." 373 U.S. at 360.[51]

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of the Securities Exchange Act that might oust conflicting provisions of state law. If the exchange rule in issue before this Court did involve a matter sufficiently important to the Act's objectives to be within the ambit of the Commission's pervasive regulatory oversight as delineated by the Act, state law in conflict with the rule would be preempted" (footnote omitted.).

[50] Since none of the subject matter categories of Section 19(b) was found to suggest "that the Commission has review authority with respect to a rule requiring arbitration of employer-employee disputes" (414 U.S. at 135, n. 14), and since the relationship between compulsory employer-employee arbitration and the matters enumerated in Section 19(b) was determined to be "'extremely attenuated and peripheral, if it exists at all,'" this Court held that the exchange's arbitration rule did "not require pre-emption of contrary state law." *Id.* at 135-137.

[51] This Court's application of the antitrust laws in *Silver,* in spite of its observation that the Commission may have had au-

Furthermore, in limiting its inquiry in *Silver* to the question of whether the NYSE's action could in fact be justified as effectuating a self-regulatory goal under the Exchange Act, because *Silver* did "not involve any problem of conflict or coextensiveness of coverage with the [Commission's] . . . regulatory power" (373 U.S. at 358), this Court contrasted the inquiry it was making with the inquiry it had made in other antitrust exemption cases in which the antitrust laws potentially conflicted with an agency's regulatory powers. *Georgia* v. *Pennsylvania R.R. Co., supra,* 324 U.S. 439; *United States* v. *Radio Corporation of America,* 358 U.S. 334; *California* v. *Federal Power Commission, supra,* 369 U.S. 482; *Pan American World Airways, Inc.* v. *United States, supra,* 371 U.S. 296. In those cases this Court did not resolve the question of implied repeal of the antitrust laws on the basis of whether the challenged conduct of the regulated entity, which was subject to the agency's jurisdiction, was, as a matter of fact, necessary to make the regulatory act work. Rather this Court examined whether or not, as a matter of law, it would be repugnant to the operation of the regulatory scheme intended by Congress to apply the antitrust laws to matters arguably subject to the agency's jurisdiction.[52]

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thority to order the NYSE to adopt a rule "providing a hearing and attendant procedures to non-members," 373 U.S. 364 n.16, does not establish, as the Department of Justice argues (DOJ Br. 19-20), that the antitrust laws are to be applied to existing exchange rules subject to the Commission's jurisdiction. For, as explained above, *Silver* involved a particular instance of exchange conduct which was not pursuant to any existing exchange rule; it did not involve the validity of an exchange rule.

[52] *Accord, Otter Tail Power Co.* v. *United States, supra,* 410

B. The Exchange Act's Regulatory Scheme Will Not Work As Congress Intended if the Antitrust Laws are Applied to Exchange Activity Respecting Matters Subject to the Commission's Jurisdiction Under Section 19(b).

It is the Commission's position that reconciliation of the antitrust laws with the regulatory scheme established in the Exchange Act requires that where exchange rules are clearly subject to the Commission's jurisdiction the antitrust laws must be found to be inapplicable. The Commission's view is that in order to make its regulatory jurisdiction over exchange rules work in the manner intended by Congress, it is necessary to pre-empt the antitrust laws.[53]

The regulatory scheme established in the Exchange Act was designed to provide regulation in an area where "the complicated nature of the problems justified leaving much greater latitude of discretion with the administrative agencies than would otherwise be the case"; "a field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means." H.R. Rep. No. 1383, *supra*, pp. 6-7. Congress thus felt justified in vesting in the Commission, "within constitutional limitations, that measure of flexibility required

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U.S. 366; *Hughes Tool Co.* v. *Trans World Airlines, Inc.*, *supra*, 409 U.S. 363; *Carnation Co.* v. *Pacific Westbound Conference*, *supra*, 383 U.S. 213; *United States* v. *Philadelphia National Bank*, *supra*, 374 U.S. 321.

[53] See *Kaplan* v. *Lehman Brothers*, 250 F. Supp. 562 (N.D. Ill., 1966), *affirmed*, 371 F. 2d 409 (C.A. 7), *certiorari denied*, 389 U.S. 954. *J. R. Williston & Beane, Inc.* v. *Haack*, *supra*, [Current Binder] CCH Fed. Sec. L. Rep. ¶94,921.

in dealing with so intricate a subject matter" (*id.*), and accordingly granted to the Commission "broad discretionary powers" (*id.*)—powers to investigate the operation of the exchange market, to review existing exchange rules and to initiate prospective rules of general or particular application. This authority to formulate policy for the securities industry, and thereby in effect to legislate, cannot be exercised

> "in a cursory or incomplete manner or without having extensive hearings and examinations into the subject matter, and without permitting those interested, representing the public and groups in the securities industry an opportunity for a full expression of views."

Stark v. *New York Stock Exchange, Inc., supra,* 346 F. Supp. at 227.

Yet, if as the Department of Justice argues, district courts possessed jurisdiction under the antitrust laws over exchange operations concurrent with that of the Commission, the whole regulatory structure of the securities exchanges would be impaired. Enforcement of the antitrust laws involves no question of regulatory policy but merely application of existing standards to adduced facts.[44] A district court "acting on a single, isolated case-and-controversy record in a private suit"

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[44] "[T]he judicial function is traditionally to weigh the merits of a particular controversy, but not to engage in a consistent determination of policy or to maintain steady contact with a general and continuing problem." Walter Gellhorn, "The Administrative Agency—A Threat to Democracy?" at 517 in *Separation of Powers and the Independent Agencies: Cases and Selected Readings,* prepared for the Subcommittee on the Judiciary of the Senate Committee on the Judiciary, 91st Cong., S. Doc. No. 91-49.

is simply not equipped to consider the broad economic policies involved—the interrelationship of a particular rule to the structure of the regulated industry, and the implications of abandoning that rule. *Cf., Port of Boston Marine Terminal Ass'n* v. *Redsriaktiabolaget Transatlantic,* 400 U.S. 62, 69.

Moreover, were a district court to apply the necessary-to-make-the-Act work standard to exchange rules subject to Commission jurisdiction—in the manner intended by *Silver* to operate with respect to exchange conduct *outside* the scope of Commission authority—the very purposes of Congress in vesting the Commission with supervisory authority would be frustrated. What is necessary to make the Act work today may be unnecessary or even counter-productive tomorrow. A period of experimentation may be required in order to resolve whether an exchange's rules are appropriate for present purposes,[55] even though there may be no present answer to the question of appropriateness in the long run.

This inability of the district courts to perform the regulatory function which Congress intended to impose over exchange operations, requires the conclusion that application of the antitrust laws to exchange rules *specifically subject to the Commission's jurisdiction* would be repugnant to the Exchange Act. To make the Securities Exchange Act work, it is necessary, at the minimum, that the Commission be able to perform the policy-making functions expressly assigned to it by that Act, in the application of standards set forth in

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[55] *Cf. Delta Air Lines, Inc.* v. *Civil Aeronautics Board,* 455 F. 2d 1340, 1345 (C.A. D.C.).

that Act, through the procedures prescribed by that Act. The Exchange Act cannot be expected to work as Congress intended if district courts may render *ad hoc* decisions applying antitrust standards to matters involving the very structure of the securities industry and thereby pre-empt the Commission's policy-making functions. Antitrust jurisdiction would both (1) result in the fashioning of national policy respecting securities exchanges in part by entities which are not equipped to perform that function as Congress intended it to be performed and (2) inevitably lead to conflicts and inconsistencies in judgment between the Commission's determinations and the holdings of numerous antitrust courts. Because of this "plain repugnancy between the antitrust and regulatory provisions" (*United States* v. *Philadelphia National Bank, supra,* 374 U.S. at 350-351), the antitrust laws must be held to have been impliedly repealed with respect to matters within the Commission's jurisdiction under the Act, and in particular with respect to the commission rate structure.

Similarly, as this Court observed in *Silver, supra,* 373 U.S. at 352, Congress intended, through the Exchange Act to leave with the exchanges "the initiative and responsibility for promulgating regulations pertaining to the administration of their . . . affairs" subject to Commission jurisdiction. See S. Rep. No. 792, *supra,* at p. 13. Notwithstanding this congressional intent, this Court felt, in *Silver*, that application of the antitrust laws to exchange conduct not within the scope of Commission supervisory jurisdiction would not inhibit effective self-regulation because "under the aegis of the rule of reason, traditional antitrust con-

cepts are flexible enough to permit the Exchange sufficient breathing space within which to carry out the mandate of the Securities Exchange Act." 373 U.S. at 360. Application of the antitrust laws to conduct clearly within the Commission's supervisory jurisdiction, however, would inhibit the scheme of supervised self-regulation.

Any meaningful exercise of self-regulation will, as this Court recognized in *Silver*, 373 U.S. at 360, likely have some anti-competitive implications.[56] Thus, if, as asserted by the Department of Justice (DOJ Br. 48), the only antitrust umbrella afforded by Commission jurisdiction occurs when the Commission affirmatively promulgates a rule or order pursuant to Section 19(b)[57] then the exchange could be expected, contrary to congressional intent, to abdicate all but the most innocuous of their self-regulatory responsibilities and leave all initiative to the Commission in order to avoid the risk of substantial antitrust liability for engaging in self-regulation outside the umbrella of a Commission directive. Moreover, this risk of antitrust liability would almost certainly result in the exchange's resistance to informal Commission requests and directions which, in the Department of Justice's view, would not provide any umbrella against antitrust attack for anti-

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[56] See also *J. R. Williston & Beane* v. *Haack*, *supra*, CCH Fed. Sec. L. Rep. ¶94,921.

[57] Indeed, the Department of Justice does not, apparently, even regard a formal Commission order registering an exchange and approving its rules pursuant to Section 6, as providing immunity from antitrust attack. See *United States* v. *Chicago Board Options Exchange*, No. 73 C 1085 (N.D. Ill., complaint filed April 26, 1973); DOJ Br. 42.

competitive action. In consequence, the congressional scheme which specifically contemplated that self-regulatory judgments would be made by the exchanges in the first instance would be abrogated and the cooperative partnership between public and private regulation established in the Act would be seriously eroded.

C. Antitrust Exemption for Exchange Conduct Subject to the Commission's Jurisdiction Is Compelled by This Court's Pronouncements Concerning Implied Repeal of the Antitrust Laws with Respect to Other Regulatory Schemes

1. Ricci v. Chicago Mercantile Exchange is consistent with recognizing an antitrust exemption for exchange rules subject to Commission jurisdiction

The Department of Justice recognizes that this Court in *Silver* did not reach the question of antitrust immunity with respect to exchange rules and practices subject to the Commission's jurisdiction, but rather noted that this question would present "a different case." 373 U.S. 360. The Department of Justice, however, says that *Ricci* v. *Chicago Merchantile Exchange,* 409 U.S. 289, is that "different case"[88] and relies heavily upon that decision. This reliance is misplaced. As the Chief Justice pointed out in his concurring opinion in *Ricci,* this Court in that case did not resolve the issue left open in *Silver.* As he said: "Indeed, the *Silver* problem is not before us." 409 U.S. at 308.

Ricci, like *Silver,* involved a private dispute between the petitioner Ricci and an exchange, in that case the

[88] DOJ Br. 20.

Chicago Merchantile Exchange. Ricci, contending that the exchange had improperly terminated his membership in violation of the rules of the exchange, the Commodity Exchange Act, 7 U.S.C. 1 *et seq.*, and the anti-trust laws, filed an action in the district court. The district court dismissed the complaint, and on appeal the court of appeals directed the district court to stay further proceedings to permit administrative action by the Commodity Exchange Commission. This Court affirmed. In so doing, this Court, like the court of appeals, did not reach the question of antitrust immunity. All that was involved was an issue of primary jurisdiction over the particular dispute. This Court, 409 U.S. at 304, said the issue in *Ricci* "seems to depend in the first instance on whether the transfer of Ricci's membership was in violation of the Act for failure to follow exchange rules. That issue in turn appears to pose issues of fact . . ." [9] Insofar as *Ricci* is relevant at all to this case, it tends to support not reject antitrust immunity in the case at bar.

Essentially, this Court in *Ricci* affirmed reference to the Commodity Exchange Commission because it believed that factual findings of the administrative agency would "be of material aid in resolving the im-

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[9] This Court, 409 U.S. at 305 n. 15 elaborated on these factual issues as follows:

"Likely issues for the fact-finder are whether Ricci revoked the transfer authorization before or after he was informed that his membership was transferred; whether the transfer authorization was valid; whether Siegel had a lien against Ricci's membership because of its loan to Ricci for the purchase of a membership; whether Siegel owed brokerage fees to Ricci; and if so, whether these brokerage fees could be offset against the debt for the membership purchase."

munity question." 409 U.S. at 302. This was true because, if the agency determined that the action of the exchange in terminating Ricci's membership was a violation of the rules of the exchange and therefore of the Commodity Exchange Act[60] then "the immunity issue will dissolve." 409 U.S. at 306. If, on the other hand, the agency were to find that the action of the exchange was in conformity with its rules, there would then be presented a question as to antitrust immunity which was "plainly substantial" 409 U.S. at 303,, and the administrative decision would assist the court in arriving "at the essential accommodation between the antitrust and the regulatory regimes." 409 U.S. at 307.

This Court concluded in *Ricci* that the question of whether the Chicago Merchantile Exchange could terminate Ricci's membership as a result of a dispute concerning indebtedness, without incurring antitrust liability, presented a "substantial" question as to immunity. In the light of this conclusion, the present case involving, as it does, the viability of the Securities and Exchange Commission's authority to regulate the structure and operations of the securities exchanges pursuant to express statutory mandate, would seem to present a clear case for such immunity.

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[60] The Commodity Exchange Act, 7 U.S.C. 1, *et seq.*, requires a "contract market," such as the Merchantile Exchange, to have rules, which must be filed with the Secretary of Agriculture, and imposes a statutory duty upon such an exchange to enforce its own rules. That Act also empowers the Commodity Exchange Commission to conduct administrative proceedings for the purpose of determining whether or not a commodity exchange is enforcing its rules and to impose sanctions if such a failure of enforcement is found. It was for this type of determination that this Court referred Ricci's dispute to the agency.

The Department of Justice relies on *Ricci* for two principal propositions. First, that the antitrust courts rather than the administrative agency have authority to decide whether antitrust immunity exists (DOJ Br. 17)[61] and secondly, that the issue of antitrust immunity can be resolved only upon a "full record" because what is involved is "an aspect of the rule of reason."[62] (DOJ Br. 17, 24).

As to the first point, we do not contend that this Commission has exclusive authority to determine whether there is antitrust immunity, but, on the contrary, we recognize that this question is properly before this Court. Our position, of course, is that this Court should decide—as have the courts below—that on the circumstances relevant to this case immunity does exist.

As to the second point, this Court did conclude in *Ricci* that an administrative record as to the facts involved in Ricci's dispute with the exchange would be

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[61] The Department of Justice relies particularly upon a footnote in the *Ricci* opinion in which this Court referred to the fact that there was no express grant of antitrust immunity in the Commodity Exchange Act and concludes that Congress did not intend the *adjudicative* authority given the Commodity Exchange Commission to be a complete substitute for judicial enforcement of the antitrust laws. (DOJ Br. 22) That proposition does not support the contention that the Commission's *regulatory* jurisdiction over stock exchanges is to be superseded by the antitrust laws.

[62] The suggestion of the Department that under *Silver* the issue now before this Court is "an aspect of the rule of reason" misreads the *Silver* decision (DOJ Br. 24). This Court indicated in *Silver* that, while no antitrust immunity existed in the *absence* of Commission power to review a particular exchange exercise of self-regulation, even in that situation, and only after that finding, the rule of reason could be applied to permit the exchange "sufficient breathing space within which to carry out the mandate of the Securities Exchange Act." 373 U.S. 360.

helpful to the antitrust court, although it did not suggest that such a record was essential. In the case at bar, however, we believe that both of the courts below by summary judgment properly disposed of the issue as to whether the Commission's express statutory authority to regulate and supervise the stock exchanges should be superseded and disrupted by antitrust challenge. There is not any real dispute as to the facts. The exchanges do fix commission rates and have done so for over 180 years, and there is no doubt as to the Commission's authority over that practice. The question before this Court is not, as the Department of Justice seems to suggest, whether the rates prevailing at any particular time were reasonable or even whether it was necessary to have fixed rates at all under the conditions prevailing at the time this plaintiff commenced his action. Rather, the issue is whether the Commission's jurisdiction over the subject of commission rates should be preserved as a part of the comprehensive scheme for Commission regulation of the securities markets.

This point is vividly illustrated by the concession of the Department of Justice that "If the SEC were to order the exchanges to adhere to a fixed commission rate system of some kind, no antitrust liability could arise." (DOJ Br. 48). A fixed rate system existed when the Exchange Act was adopted, and Congress, as well as the Commission, recognized its existence. No Commission order was required to create such a system, but the continuance of a fixed rate system *was* predicated upon a formal order of the Commission issued in 1934 registering the defendant exchanges as national securities exchanges under Section 6 of the Exchange Act. As

we have observed earlier, any exchange seeking to be registered as a national securities exchange in 1934 was required to file with the Commission copies of its articles of incorporation, bylaws and all rules and regulations—which included its rules requiring its members to charge fixed commission rates on all transactions effected on the exchange. The Commission, then, in 1934, after finding that the rules and regulations of the defendant exchanges (including rules relating to a fixed commission rate system) were "just and adequate to insure fair dealing and to protect investors" exercised its jurisdiction under Section 6(d) of the Exchange Act to register the exchanges by the issuance of a formal "order."[43]

As we observe at some length in Part II D *infra*, the Commission has exercised its jurisdiction over the fixed rate system ever since. The Commission has conducted studies and held hearings over the years to study the fixed rate system as conditions changed in the securities markets. The Commission initially responded to changing conditions in the securities markets by taking various steps—including the informal procedures included in its package of regulatory tools under the Exchange Act—designed to modify the commission rate structure without, at the same time, unnecessarily disrupting exchange operations or impairing investor protection. Ultimately concluding that a fixed commission rate system was no longer necessary or appropriate, the Commission in 1975, by rule directed the exchanges to

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[43] See Order of Commission issued to NYSE, (September 28, 1934) (A-238). In its order the Commission also specifically made reference to its power "under Section 19 and other sections of said Act" to alter or supplement rules of the exchange (A-239).

terminate that system, thus in effect ordering them *not* to adhere to such a system, a result which the Department of Justice now applauds. Securities Exchange Act Release No. 11203 (January 23, 1975) (Doc. App. 109).

Thus, it is clear that the fixed commission rate system of the defendant exchanges was initially approved by the Commission by formal "order" in 1934, has been consistently approved, modified and altered by the Commission through its less formal regulatory tools during the intervening 41 years, and has culminated in 1975 through the issuance of another formal "order" by the Commission. In view of this history of the Commission's exercise of its statutory jurisdiction over the practice of fixed commission rates, it is particularly difficult to comprehend how the Department of Justice can now urge application of the antitrust laws to this practice and at the same time concede that "no antitrust liability could arise" if the SEC "were to order the exchanges to adhere to a fixed commission rate system." DOJ Br 48.

The foregoing demonstrates the Department of Justice's misplaced reliance on *Ricci*. In this case there exists specific statutory jurisdiction by an administrative agency over an important aspect of a regulatory scheme, which is to be, and has been, exercised through formal orders and other regulatory means specifically contemplated by the Act. There simply are no facts needing resolution by a trier of fact. What we have here is a question of law—whether there is a plain repugnancy between the antitrust laws and the regulatory scheme embodied in the Exchange Act—precisely the

issue of implied repealer this Court said in *Ricci* would be reached *after* the factual issues were resolved."[44]

2. Each of the elements which this Court has considered necessary in order to find an implied repeal of the antitrust laws is present here.

The Commission's position, that exchange rules specifically subject to its jurisdiction are immune from antitrust attack, is in harmony with this Court's past precedents. An examination of this Court's decisions regarding implied repeal of the antitrust laws with respect to other regulatory schemes makes plain that repugnancy between the antitrust laws and the regulatory scheme turns upon the existence of two elements attendant to the regulatory scheme; both of these elements are present in the Exchange Act.

First, this Court has required that the conduct challenged under the antitrust laws be subject to the juris-

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[44] Both the majority and dissent suggested in *Ricci* that the jurisdiction of the agencies established under the Commodities Exchange Act was so limited that that regulatory scheme could not be viewed as a substitute for the application of the antitrust laws. 409 U.S. at 302, n. 13, 312-313. As we have shown above, the jurisdiction of the Commission established under the Securities Exchange Act to supervise the rules of securities exchanges is plenary and therefore markedly different from the regulatory scheme respecting commodities exchanges existing at the time of the *Ricci* dispute. Indeed, because it viewed the regulatory scheme over commodities exchanges, which operated at the time of the *Ricci* dispute, as inadequate, Congress has recently created "an agency comparable in stature and responsibility to the Securities and Exchange Commission" to regulate more completely commodities exchanges. Senate Committee on Agriculture and Forestry, *The Commodities Futures Trading Commission Act of 1974*, 93d Cong., 2d Sess., p. 2 (Committee Print); *see also* 120 Cong. Rec. 2924, 2928.

diction of the regulatory agency to supervise and review. Thus, in *Pan American World Airways, Inc.* v. *United States, supra,* 371 U.S. at 305, in finding an implied repeal, this Court specifically noted that the "acts charged . . . are precise ingredients" of the administrative agency's authority. On the other hand, where this Court has found that the regulated entity's anti-competitive conduct is outside the scope of agency supervisory jurisdiction vested by a regulatory statute, it has refused to recognize an implied repeal of the antitrust laws. See *Georgia* v. *Pennsylvania R.R. Co., supra,* 324 U.S. at 456-457; *Silver* v. *New York Stock Exchange, supra,* 373 U.S. 341; see also *Federal Maritime Commission* v. *Seatrain Lines, Inc., supra,* 411 U.S. 726 (where a one-time rate fixing agreement was found to be outside the scope of the Federal Maritime Commission's express authority to grant antitrust immunity to ongoing rate fixing agreements between shippers, and hence subject to antitrust attack); *compare Hughes Tool Co.* v. *Transworld Airlines, Inc., supra,* 409 U.S. 363 (finding an exemption from the antitrust laws with respect to conduct subject to the jurisdiction of the Civil Aeronautics Board) *with id.* at 389 (dissenting opinion urging that the challenged conduct in that case was outside of the CAB's "substantive mandate" to review). As the preceding analysis of the structure and policy of the Exchange Act makes clear, the Commission was expressly granted continuing supervisory jurisdiction over any important matters relating to stock exchanges including, specifically, the fixing of commission rates.

Second, this Court has refused to find an implied

repeal of the antitrust laws, even where a regulatory agency has jurisdiction to supervise the challenged conduct and even when in the course of exercising that jurisdiction the agency is required to consider competitive factors, if in the context of the regulatory scheme the agency's jurisdiction is not intended to be a substitute for the antitrust function. See *California* v. *Federal Power Commission, supra,* 369 U.S. 482; *United States* v. *Philadelphia National Bank, supra,* 374 U.S. 321; *Otter Tail Power Co.* v. *United States, supra,* 410 U.S. 366. But where it has found that the question of whether the challenged conduct "meet[s] the standards of competition and monopoly provided by the [regulatory] Act is peculiarly a question for the administrative agency," then in order to avoid the collision of two regimes which might result "[i]f the courts were to intrude independently with their construction of the antitrust laws," this Court has recognized an implied repeal. *Pan American World Airways* v. *United States, supra,* 371 U.S. at 309-310. Recognition of an implied repeal in such circumstances is consistent with this Court's repeated concern to avoid "sporadic action by federal courts [which] would disrupt an agency's delicate regulatory scheme. . . ." *United States* v. *Radio Corporation of America, supra,* 358 U.S. at 348; see also *Carnation Co.* v. *Pacific Westbound Conference, supra,* 383 U.S. at 220-221. While the Commission must, and does, consider competitive factors in supervising exchange rules, it must balance those factors against other policies of the Exchange Act in order to formulate a complete regulatory policy which it finds to be "necessary or appropriate."

Moreover, as we have demonstrated, the Commission's exercise of its regulatory mandate will not work if the courts independently subject matters within the Commission's Section 19(b) jurisdiction to "their construction of the antitrust laws." *Pan American World Airways* v. *United States, supra*, 371 U.S. at 310.

D. The Public Record of Commission Supervision Over the Exchanges' Commission Rate Structure Illustrates the Necessity of Leaving Such Matters Solely to the Jurisdiction of the Commission.

Since application of the antitrust laws to exchange rules concerning the fixing of minimum commission rates as well as to all other exchange practices that are within the scope of the Commission's supervisory jurisdiction would be inimical to and would frustrate the regulatory scheme of the Exchange Act, such rules and practices must be considered to be immune from antitrust attack even where they have not been specifically mandated by a formal rule or order of the Commission under Section 19(b). The necessity for pre-emption of the antitrust laws is fully supported by the public record of the Commission's active exercise of its jurisdiction over the commission rate structure of the exchanges. This record illustrates the effectiveness of the formal and informal processes contemplated by the Act for dealing with the complex and subtle issues posed in formulating policy with respect to exchange rules. It also substantiates the necessity for leaving exchange self-regulatory conduct, with respect to matters which Congress brought within the scope of the Commission's authority, to the exclusive jurisdiction of the Commission.

The respective fixed commission rate structures of the NYSE and the AMEX were approved by the Commission in 1934 when the Commission granted the applications of those exchanges for registration as "national securities exchanges" pursuant to Section 6 of the Exchange Act (43a-44a, 217a, 229a-239a). Thereafter, the defendant exchanges amended their rules respecting commission rates from time to time, submitting copies of these amendments upon their adoption to the Commission for its review in accordance with Section 6(a) of the Act (44a, 218a).

Pursuant to a congressional mandate in 1961, 15 U.S.C. 78s(d), the Commission published in 1963 a six-volume Special Study of Securities Markets, H.R. Doc. 95, 88th Cong., 1st Sess. (hereinafter cited as "Special Study"), which contained the results of a detailed investigation by the Commission's staff of the operation of the securities industry. Commencing in 1964, the Commission's staff and the exchanges initiated discussions to implement the recommendations of the Special Study (44a, 219a-220a). Then, in 1968, in order to examine fully certain practices pertaining to fixed stock-exchange-commission rates, the Commission held investigatory hearings, pursuant to Section 21(a) of the Exchange Act, 15 U.S.C. 78u(a),[45] on the commission rate structure of securities exchanges and the

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[45] Section 21(a) of the Exchange Act authorizes the Commission "in its discretion, . . . to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid . . . in the prescribing of rules and regulations. . . [under the Exchange Act], or in securing information to serve as a basis for recommending further legislation concerning the matters to which this title relates."

securities industry (99a, 284a-240a).[66] Again, commencing on October 12, 1971, also pursuant to Section 21(a) of the Exchange Act, the Commission held further public hearings on the structure of the securities markets. Interested persons appeared and presented their views with respect to various interrelated matters concerning the appropriateness of modifications to the structure of the securities markets.[67] Upon conclusion

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[66] The Commission announced the commencement of these hearings on May 28, 1968. See Securities Exchange Act Release No. 8324 (1968) (286a-287a). These hearings, which were conducted through the summer of 1971, were intended to elicit information on, among other things, how the securities industry worked and whether "a minimum exchange commission rate structure is necessary" to the operation of the securities industry. *Id.*

[67] In Securities Exchange Act Release No. 9315 (August 26, 1971) the Commission announced that the following matters were to be considered during the hearings:

"(1) The desirability, structure and means of developing a national system of securities exchanges and the relationship of such a system to other securities markets;

"(2) So-called 'institutional membership' on exchanges including (i) exchange membership by financial institutions (such as insurance companies, trust companies, foundations, investment companies and pension funds); (ii) exchange membership by affiliates of financial institutions such as their investment advisers, managers, parents, subsidiaries or other affiliates, who may utilize such memberships either to execute portfolio transactions for an institutional affiliate or in one way or another to facilitate the recapture of commissions by an institution or to conduct a general securities business as an exchange member, or any combination of the foregoing; (iii) exchange membership by other organizations whose primary business may not be that of a broker or dealer or their affiliates; (iv) whether and the conditions under which any of the foregoing persons should be permitted to engage in the business of a broker or dealer in securities (aside from acting as underwriters for the shares of one or more investment companies);

of these hearings, and following publication in 1971 of a second Congressionally-mandated study of the securities markets by the Commission—*The Institutional Investor Study,* H.R. Doc. No. 92-64, 92d Cong., 1st Sess.—the Commission issued a *Statement on the Future Structure of the Securities Markets* (February 2, 1972) (hereinafter cited as "Policy Statement"), in which it enunciated its commitment to the creation of a central market system in listed securities (239a).

In the Policy Statement, the Commission noted that one of the major barriers to the central market system was the fixed minimum brokerage commissions. Policy Statement, p. 15 (385a-386a).[48] Nevertheless, the Com-

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"(3) Restrictions on access of non-members to exchange markets and of exchange members to the third markets;

"(4) The reasons for differing regulation of securities markets and the kind of additional or modified regulation, if any, which may be needed;

"(5) The need for additional disclosure of information on prices, volume and quotations in all markets, and the nature thereof through a composite tape or otherwise, and

"(6) Competition among exchange and between exchanges and other markets."

[48] The Commission observed that fixed minimums may not only have been at an unreasonable level, but also may have caused the serious side effects of

"(a) Dispersion of trading in listed securities

(b) Reciprocal practices of various kinds.

(c) Increasing pressure for exchange membership by institutions."

Policy Statement, p. 15 (385a). These side effects, the Commission stated, were obstacles to the central market system in that they cause

"certain markets and market makers . . . to choose to stay outside the system in order to compete in service charges as well as in execution, as the third market does, or in order to compete, as certain regional exchange do, for institutional business by directly or indirectly providing institutions with rebates of commissions." *Id.*

mission observed that "we are dealing with an industry which has operated under fixed commission rates for a very long time." *Id.* (386a). Consequently, while the Commission expected that the goals of "competitive rates and the creation of a centralized market system" would have desirable incidents, it was at the same time concerned that competitive rates might result in

> "deterioration in standards of service and responsibility or . . . higher transaction costs owing to increased spreads and fluctuations, or [the possibility that] . . . investment managers [will make] . . . visible commission cost an exclusive criterion in deciding where to place their executions and [thus ignore] . . . through carelessness or fear of criticism, the elements of skill, knowledge, judgment and advice."

Id. at p. 14 (384a).

In the Commission's view, "[a]ny changes in the commission structure should not reverse" the ongoing process of upgrading broker-dealer "standards of service to the public including the provision of adequate information, advice, care and responsibility." *Id.* at pp. 15-16 (386a). Thus, the Commission concluded that "[i]t is necessary to measure the effect of competitively determined commissions very carefully on a step-by-step basis." *Id.* at p. 15 (386a). While "[t]he principal argument in favor [o]f fixed minimum commissions is the severe decline in the revenue of the securities industry predicted to result if competitive rates were suddenly introduced on all institutional business," it was the Commission's opinion that the indus-

try should be able to adjust to the introduction of competitive rates, "at least on large orders, at a measured deliberate pace." *Id.* at p. 16 (387a).[69]

These views reflected a reaffirmation of conclusions that the Commission had earlier reached "that fixed minimum commissions on institutional size orders are neither necessary nor appropriate" (351a, 353a).[70]

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[69] The Commission's letter, transmitting the Institutional Investor Study to the Congress, stated:

"We have . . . taken initial steps to require competitive rates . . . which we believe will have ameliorating effects on future developments in a number of the areas studied. Assuming that the step called for is timely implemented by the . . . [NYSE], the Commission's subsequent steps in this and related areas must necessarily be guided to a considerable extent by its experience with the initial step. . . . In this situation we believe the sound regulatory course is to proceed with caution on any further concrete recommendations concerning the structure of the securities markets" (footnote omitted).

Securities and Exchange Commission, *Institutional Investor Study*, H.R. Doc. No. 92-64, 92nd Cong., 1st Sess., Pt. 1, pp. vii-viii.

The Commission's approach of a phased introduction of competitive rates has been endorsed in Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess., *Securities Industry Study*, p. 60 (Committee Print), in Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess., *Securities Industry Study*, at p. 62. (Committee Print); and in United States Department of the Treasury, *Public Policy for American Capital Markets*, p. 6 (1974).

[70] The Commission's reservation concerning the exchanges' fixed minimum commission rate system as it related to large trades dates back to the Special Study of 1963. See Special Study, pp. 328-351. In the Special Study it was noted that since the commission rate structure of the exchanges allowed no discount for large volume trades, although the cost per share to the broker effecting such transactions was significantly less than for smaller volume trades, certain practices occurred. *Id.* Among these were the execution of large trades off the exchanges in order to take advantage of

Thus, on October 22, 1970, the Commission had taken a position in a letter to the NYSE that fixed minimum commission rates "for that portion of orders in excess of $100,000" were unreasonable. Securities Exchange Act Release No. 9007 (1970) (384a).[71] The Commission later determined "not [to] object to the . . . [NYSE's] commencing competitive rates on portions of orders above a level not higher than $500,000 rather than the $100,000 figure . . . ," but insisted that this be done by April 10, 1971 (353a-354a). Most exchanges had implemented competitive commission rates above that level by April 5, 1971. Securities Exchange Act Release No. 9148 (April 14, 1971).

Thereafter, the Commission observed the effect of negotiated rates above $500,000.[72] Having done so, the

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discounts derived from the economies of size and the practice by exchange members of making unauthorized reciprocal payments at the direction of persons who channeled large trades to the exchange member. *Id.* See also 219a-220a.

For a period after the Special Study, the Commission's staff and representatives of the exchanges met to discuss implementing the recommendation of the Special Study that these practices be curbed (44a-45a). Then, in 1968, the Commission took direct steps to relieve the problems by requesting the exchanges to integrate into their commission rate system a volume discount or alternatively to eliminate minimum commissions on portions of orders above $50,000 (46a).

[71] The Commission's conclusion that it was unreasonable for securities exchanges to prescribe fixed rates on portions of orders above $100,000 was conveyed to the exchanges as part of a letter to the NYSE. The letter was intended to advise the NYSE of those aspects of a new increased commission rate schedule prepared by the NYSE which the Commission found not to be reasonable. The NYSE's new schedule originated as an interim surcharge that the NYSE sought to place on small orders in order to compensate for severe financial conditions which its members suffered in 1969-1970.

[72] In its letter of October 22, 1970 to the NYSE (see p. 67

Commission concluded in its February 1972 Policy Statement that while

> "further reductions in the breakpoint [*i.e.*, the transaction size above which rates must be negotiated] might have a more severe impact on the income of certain kinds of member firms, on the services they provide, on their role in the capital markets, including the distribution of securities,

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supra) the Commission had requested the exchange to submit no later than June 30, 1971, a "new rate schedule of scaled percentage charges based upon the amount involved in an order" (352a). On April 14, 1971, the Commission informed the securities industry that any further reduction of the negotiated rate breakpoint would be deferred pending the submission expected from the NYSE on June 30, 1971. Securities Exchange Act Release No. 9148 (April 14, 1971). The Commission intended:

> "to observe the workings of competitive commission rates on orders in excess of $500,000 to consider carefully all questions which arise as a result thereof."

Id.

In September 1971, after receipt and analysis of the submissions and the public comments thereon, the Commission announced that it was not disposed at that time to lower further the breakpoint to a level below $500,000, but would continue to

> "study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000."

Securities Exchange Act Release No. 9351 (September 24, 1971). (Doc. App. 158) The Commission advised the NYSE that since "a rule dealing with commission rates is necessarily dependent for its validity upon the continuation of the conditions and circumstances justifying the reasonableness of the rates" the NYSE should continue to "review its commission rate structure," "gather necessary data from its members" and submit any modifications or changes in its commission rate structure to the Commission "to enable [the Commission] to exercise its continuing regulatory oversight." *Id*, (Doc. App. 157).

> and on the desires of institutions and their managers to recapture commissions or otherwise use them for their benefit,"

it would nevertheless be appropriate for a $300,000 breakpoint to take effect in April of 1972. Policy Statement, p. 16 (387a, 401a).

On May 31, 1973, in response to severe financial conditions in the securities brokerage industry, the NYSE submitted to the Commission proposed amendments to its constitution and rules which would result in an increase in the commissions charged by NYSE members (Doc. App. 24). Shortly thereafter—on June 6, 1973—the Commission commenced "a public investigatory hearing . . . to consider whether any changes should be made in the rules, policies, practices and procedures of one or more registered national securities exchanges respecting commission rate schedules" Securities Exchange Act Release No. 10206. (Doc. App. 24). On September 11, 1973, the Commission publicly announced its "conclusions concerning the commission rate proposals of the . . . [NYSE]. . . ." (Doc. App. 27). The Commission concluded that it would not object if the NYSE should immediately adopt its proposed commission rate increases, effective through March 31, 1974. The Commission further concluded that it would not object to the continuation of those increases from April 1, 1974, through April 30, 1975, subject to the condition that the NYSE first adopt certain other rules to become effective by or before April 1, 1974." The

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[73] Specifically, the Commission's conclusion not to object to the continuation of the increase after April 1, was conditioned upon the adoption of rules to "(a) eliminate that portion of NYSE Rule 383

Commission stated in its announcement, however, that "it will act promptly to terminate the fixing of commission rates by stock exchanges after April 30, 1975, if the stock exchanges do not adopt rule changes achieving that result." (Doc. App. 28). The Commission further concluded that it would "not initiate in April 1974, a breakpoint reduction below $300,000 respecting the portion of orders above which rates may be competitively determined," Securities Exchange Act Release No. 10383 (Doc. App. 28).

Subsequently, in a letter from the Commission to the NYSE, dated December 14, 1973 (Securities Exchange Act Release No. 10560; Doc. App. 29), the Commission explained that in view of the fact that in the Exchange Act "rules concerning exchange-required fixed commission rates [were matters] that Congress entrusted to the exchanges in the first instance, at least as long as the fixing of commission rates should be permitted, the Commission after having considered a number of factors, "could not conclude that the NYSE's rate proposal was unreasonable" (Doc. App. 32-33). Accordingly, the Commission was "motivated . . . to raise no objection to the NYSE's rate increase for the period ending March 31, 1974" (Doc. App. 36).

The Commission also explained that its

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prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedules and (b) [to] permit, but . . . not require, member firms to provide less than a full range of brokerage services presently furnished customers in return for a discount of up to 10 percent from the commission rate schedule . . . [that had been proposed by the NYSE]" (Doc. App. 28).

"conclusion that it would be appropriate to require exchanges to eliminate fixed rates effective by April 30, 1975, of course, also had some influence on its conclusion not to object to the specific rate proposed by the NYSE" (Doc. App. 36).

The Commission reasserted that

"the long history of fixed rates argues against a precipitous elimination of the fixed rate system. It is appropriate, for the protection of investors and in the public interest, that stock exchange firms be given an opportunity to develop business strategies and adjust their operations to a competitive-rate environment. It is not appropriate to risk the possibility that undue haste might threaten the ability of the industry to fulfill its essential function of serving the needs of investors and corporations seeking capital from the public. The severe financial experience of the member firm community in the last half of 1972 and the first seven months of 1973 indicated that, without some form of rate increase, the ability of the industry to function would be impaired at the very time that it was expected to accomplish a transition to a competitive rate system (in a relatively short period of time), as well as the implementation of an extremely large number of other regulatory initiatives of a significant nature." (Doc. App. 37).

The Commission further stated that, while it would not necessarily require the NYSE, as a condition to continuing the rate increase after April 1, 1974, to adopt a rule allowing customers a 10% discount from

the fixed rate for reduced services from their broker,"[74] it adhered to the objective reflected in its September 11, 1973 conclusions "that the exchanges take steps to effect a meaningful experimental period prior to the introduction of completely unfixed rates. . . ." (Doc. App. 39). The Commission explained that with the "limited price competition [it expected] . . . all exchanges will effect," a broader range of investors would "have the opportunity to react to" competitive rates than would result from simply lowering the competitive-rate breakpoint below $300,000. (Doc. App. 40) Accordingly, the Commission determined that it would not be necessary to lower the breakpoint in April of 1974.

In response to the Commission's reaffirmation of its objective to provide for a meaningful experimental period, the NYSE submitted to the Commission proposed amendments to its constitution and rules to allow for competitively-determined commission rates on public orders of $2,000 or less commencing on April 1, 1974 (Securities Exchange Act Release No. 10670. Doc. App. 42). The NYSE's proposed rule changes did not provide, however, that intra-members rates on portions of orders of $2,000 or less be competitively determined. The Commission decided not to raise any objection to these rule changes but conditioned its non-objection on the expectation that the exchanges will "promptly . . . implement any necessary rule and constitution changes" if "the Commission determines, as a result of its study of the matter, that exchange ex-

[74] See note 73, *supra*.

periments with limited price competition should be broadened to encompass intra-member rates" (Doc. App. 44).[18]

Following the Commission's hearings on intra-member rates, the Commission announced on September 19, 1974, that it had written to the presidents of each registered securities exchange stating (1) that in its view ample opportunity had been provided exchange members "to develop business strategies for, and to adjust their operations to, an unfixed rate environment"; (2) that it was "not persuaded, on the basis of the data and views obtained as a result of [the intra-member rate hearings] that its policy conclusions of September 11, 1973, should not also be applicable to intra-member rates," and (3) that the exchanges were formally requested, pursuant to the Commission's authority vested "under the Securities Exchange Act and particularly Sections 2, 6, 10, 11, 19 and 23 thereunder", to "effect necessary changes in their constitution, rules, and practices" to eliminate fixed rates "effective on or before May 1, 1975." Securities Exchange Act Release No. 11019 (September 19, 1974) (Doc. App. 60-64).

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[18] In order to aid its study of the matter, the Commission, on April 23, 1974, announced the commencement of public investigatory hearings beginning on May 29, 1974

"to gather comments, views and data concerning whether the initiation in the near future of a limited experiment in competitive intra-member rates of commissions on orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists, and whether it is necessary or appropriate in the public interest or for the protection of investors for exchanges to maintain any prescribed schedules of intra-member rates of commission" Securities Exchange Act Release No. 10751 (Doc. App. 49).

As a result of responses received by the Commission with respect to its September 19 request, the Commission determined to publish for comment, on October 24, 1974, proposed Rules 19b-3 and 10b-22 which would prohibit exchange rules fixing commission rates and establish procedures to regulate agreements to fix commissions on exchanges. Securities Exchange Act Release No. 11073 (October 24, 1974) (Doc. App. 65). The Commission also announced that it would hold hearings, beginning on November 19, 1974 with respect to its proposed rules. *Id.*[76]

Following hearings on its proposed rules [77] the Commission announced on January 23, 1975, adoption of Rule 19b-3, proscribing exchange rules or practices fixing commission rates as of May 1, 1975.[78] Securities

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[76] In Securities Exchange Act Release No. 11093 (November 8, 1974), the Commission provided, in anticipation of its hearings, a synopsis of the Commission's extensive regulation of fixed rates since 1963. (Doc. App. 81).

[77] The Antitrust Division of the Justice Department submitted a memorandum in these hearings in which it asserted that "the thrust of the [Exchange Act] is to authorize the Commission to take such remedial or reform actions with respect to exchange practices as the Commission deemed necessary or appropriate to effectuate the purposes of the Act"; and as a result, the Commission may "prohibit the exchanges and their members from fixing commission rates." Comments of the United States Department of Justice, Proposal to Adopt Securities Exchange Act Rules 19b-3 and 10b-22, Securities Exchange Act File No. 4-176 (December 10, 1974), pp. 6-7. Apparently the Department of Justice believes that the powers granted to the Commission in Section 19(b)(9) to regulate the fixing of "reasonable rates of commission" gives the Commission the authority to *abolish* fixed commission rates but *no* power to authorize any level of fixed rates.

[78] Rule 19b-3 provides:

(a) No national securities exchange ("exchange") shall adopt or retain any rule of the exchange that requires, or shall

Exchange Act Release No. 11203 (January 23, 1975) (Doc. App. 109). In its release announcing adoption of Rule 19b-3 the Commission explained:

"The basic reason for the Commission's decision to adopt Rule 19b-3 was the conclusion that, under present circumstances, the free play of competition can provide a level and structure of commission rates which will better serve the interests of the investing public, the securities markets, the securities industry, the national economy and the

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otherwise, directly or indirectly, require its members, or any person associated with its members, to charge any person any fixed rate of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(b) Each exchange shall provide in its rules of the exchange that nothing therein or in its practices shall be construed to require or authorize its members, or any person associated with its members, to agree or arrange, directly or indirectly, for the charging of fixed rates of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(c) No member of any exchange, or person associated with any member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange covered by paragraph (a) of this rule.

(d) As used in this rule, the term "rule of the exchange" refers to any provision of the constitution, articles of incorporation, bylaws or rules or instruments corresponding thereto, whatever the name, of the exchange, and the term "floor brokerage commissions" refers to commissions applicable to the execution of transactions for members or associate members of an exchange but does not include commissions for clearance services or commissions for combinations of floor brokerage and clearance services.

(e) The provisions of this rule shall become effective on May 1, 1975, except as to any rule of the exchange relating to floor brokerage commissions as to which the provisions of this rule shall become effective on May 1, 1976.

> public interest than any system of price fixing which can reasonably be devised. . . . It should be emphasized, however, that the Commission's conclusions are not based upon any simplistic notion that competition is a "good thing" in all lines of endeavor, including a regulated industry, and that, therefore, competitive rates should be substituted regardless of experience and circumstances. Rather, this conclusion is based upon the entire experience of the Commission and the securities industry with fixed rates, particularly during the last decade and more, and the intensive studies which have been made of that subject by so many competent persons." *Id.* at pp. 24-25 (Footnote omitted) (Doc. App. 133-134).

The Commission specifically cautioned, however, that its adoption of Rule 19b-3

> "does not reflect any judgment by the Commission that the fixed commission rate always was bad or that it was, or now is, illegal, or that fixed commissions could never be appropriate in the future. Rather, it simply reflects a conclusion, based upon the Commission's experience and the abundant data alluded to [in] its release that, under the conditions now existing, fixed minimum commissions should terminate at the times specified in the rule. It is not possible to predict future developments or future conditions, and it is conceivable that unforeseen developments could require the Commission to reinstitute some form of fixed rates, although the Commission does not anticipate or believe that this will become necessary."

Id. at p. 26 (Doc. App. 136-137).[79]

The Commission's program since 1968 of modifying the exchanges' fixed rate structure has been paralleled by related Commission initiatives which affected the exchanges' commission rate structure as it related to the proposed central market system. One of these initiatives was a program to provide non-member broker-dealers with greater access to the exchange market while fixed rates continued on the exchanges.[80]

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[79] Because the Commission recognized (1) "that the transition to competitive public rates will create problems of adjustment and accommodation for the exchanges and a deferral of the change as to floor brokerage rates may facilitate the ability of the exchanges to accomplish a smooth transition to a new environment"; (2) that certain exchange members apparently did not realize that the Commission's September 11, 1973 conclusions were applicable to floor brokerage rates as well as non-member rates, and thus "may not have had the benefit of the advance notice and time for planning with respect to floor brokerage rates which the September 11th notice was intended to provide"; and (3) that "floor brokerage rates have considerably less impact on public investors than do public rates," it concluded that the date for elimination of floor brokerage rates should be May 1, 1976, instead of May 1, 1975. *Id.* at pp. 1-2 (Doc. App. 110).

[80] The NYSE, until the implementation of the Commission's program in this area, prohibited its members from splitting commissions for transactions executed on the NYSE. The AMEX had a similar prohibition. These prohibitions, known as anti-rebate rules, were intended to preserve the integrity of the exchanges' fixed minimum commission rate system. See *Thill* v. *New York Stock Exchange, Inc., supra,* 433 F. 2d 267.

The October 22, 1970, letter in which the Commission first requested that the NYSE adopt competitively-established commissions above certain levels (see *supra,* p. 67) (352a), also instructed the NYSE to submit, no later than June 30, 1971, a plan that would, provide "for reasonable economic access to the New York Stock Exchange for non-member broker-dealers." Such a program would of course, provide non-members with a means of participating in the exchange market at rates below the otherwise applicable

A second action taken by the Commission, which relates to the fixed minimum commission rate system, was the Commission's promulgation on January 16, 1973, of Rule 19b-2 under the Exchange Act, 17 CFR 240.19b-2. The rule is intended to limit the use of exchange memberships for other than public purposes. Securities Exchange Act Release No. 9950 (January 16, 1973).[81]

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minimum commission rates. Thus, the Commission's request for a plan of non-member access, like its decision to implement negotiated rates at certain levels, reflected its conclusion that the commission rate structure, as it had been applied, was no longer necessary or appropriate under the standards contained in Section 19(b). But just as the Commission had been concerned that a precipitous leap to fully negotiated rates might have a calamitous impact upon the securities markets, it took steps to assure that changes in access for brokers would provide meaningful profits from stock exchange transactions executed for their customers, and that such changes would not occur at the expense of the stock-exchange-member sector of the securities industry. Consequently, when the NYSE in mid-1971, submitted a proposal allowing non-members a discount of 30 percent from the public rate (Doc. App. 159), the Commission insisted that

> "the discount afforded non-member broker-dealers should not be less than 40% to allow for a minimum meaningful test of this proposal" Securities Exchange Act Release No. 8324, (Doc. App. 149).

A 40 percent discount for non-members went into effect in late March of 1972.

[81] In announcing Rule 19b-2's adoption, the Commission noted that the rule satisfied several objectives, including

> "The need to structure a central market system, the need to eliminate unfair trading advantages, the need to restore and insure investor confidence in our trading markets, the need to foster meaningful competition in the securities industry, and the need to promote the orderly introduction of competitive commission rates on large-size securities transactions. . . ."

Id. at p. 188. Regulation of the use of exchange memberships was found to be necessary to implement the Commission's program of

Finally, in its recent release announcing the adoption of Rule 19b-3 the Commission addressed itself to another problem related to the problems of non-member access to exchanges and institutional membership on exchanges—namely, the question of whether the elimination of fixed rates would reduce economic incentives to retaining exchange membership.[82]

The foregoing makes clear that the Commission has since 1961 been engaged in a continuing regulatory program which has sought to examine fully the nature and effect of the national securities exchanges' fixed rate system, and which has sought to structure the exchanges' operations not only with respect to the commission rates themselves but also with respect to a myriad of interrelated and interdependent matters. It

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introduction of competitive rates because the use of exchange membership by institutions for the purpose of recapturing brokerage commissions "would be tantamount to competitive rates (or no commissions at all) on all size orders for those institutions immediately" as a result of which "the Commission's phase-in-program would . . . become an academic exercise, at best." *Id.* at p. 107.

[82] The Commission stated that while "these concerns appear exaggerated" and do "not provide an adequate basis for deferring competitive rates" since they can be dealt with in other ways, nevertheless

> "[i]f it should appear that member firms are proposing to leave the exchanges in order to execute customers' transactions by making markets off the exchange, various steps could be taken to restrict this practice to the extent necessary or appropriate in the public interest or for the protection of investors."

Securities Exchange Act Release No. 11203, p. 43 (Doc. App. 154). In this connection, however, the Commission specifically cautioned that while it intended to receive comments on this problem

> "proposals which appear on their face to be anticompetitive can hardly be acted upon in the absence of experience under competitive rates which demonstrates that they are, nevertheless, necessary or appropriate" *Id.* (Doc. App. 155).

is hard to conceive of a better example to demonstrate the necessity for entrusting exchange operations to an administrative agency with continuous supervisory jurisdiction, rather than to the *ad hoc* jurisdiction of antitrust courts.[83]

CONCLUSION

In adopting the Securities Exchange Act of 1934, Congress intended to establish a national policy for the regulation of transactions on securities exchanges. To accomplish this goal, the Commission was vested with

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[83] In order to carry out its broad regulatory responsibility over the exchange markets the Commission has an entire division consisting of 117 full time employees, its Division of Market Regulation, devoted to the development and implementation of regulatory policies and programs, as well as dozens of other staff personnel employed in other offices and divisions.

Not only does the record of Commission action with respect to commission rates illustrate the wisdom of Congress in delegating to the Commission quasi-legislative jurisdiction over the exchanges' rate structure, but the history of active exercise of Commission authority also requires that the exchanges' present rate structure be found immune from antitrust attack, even if this Court were to hold that the fact of jurisdiction by the Commission over the exchanges' fixed commission rate system alone does not afford such immunity.

The commission rate system existing at the time of the institution of this action, as well as the present system, is the product of the Commission's ongoing supervision. In the course of exercising this authority, the Commission determined that any precipitous move toward fully negotiated rates was not appropriate, but rather that the elimination of fixed rates at various levels should be the product of a deliberate, considered administrative program. It is just this type of action by a regulatory agency which this Court has held displaces the antitrust laws. *See Hughes Tool Co.* v. *Trans World Airlines, Inc., supra,* 409 U.S. 237. To allow an antitrust attack in this case "would disrupt" the Commission's delicate regulatory scheme, and would throw existing rate structures out of balance." *United States* v. *Radio Corporation of America, supra,* 358 U.S. at 348.

"broad powers over the exchanges to insure their efficient and honest functioning." [84]

But, creation of a scheme of regulation embodied in the Exchange Act did not take place in a vacuum. Rather, Congress appropriately took into consideration practices that had evolved over nearly 150 years of exchange operations without government regulation. As a result, in order to preserve the initiative and imagination of the exchanges already in existence, as well as to spur the exchanges to develop ethical and legal standards for the governance of the daily business conduct of their members, the Exchange Act explicitly contemplated that registered exchanges would be able to propose new regulatory standards and reevaluate their existing requirements. To oversee this "statutorily imposed duty of self-regulation" [85] the Commission was provided with continuous and complete regulatory control of the exchange mechanism through direct authority to adopt its own rules concerning specific areas of conduct of exchanges and their members and by the sweeping provisions of Section 19(b) empowering the Commission to alter, modify, repeal or amend exchange rules governing "any important matter." [86]

For nearly fifteen years the Commission has used its assortment of regulatory tools, whether formal, informal, or a mixture of both, to develop a cohesive policy with respect to the structure and functioning of the securities markets, a structure which in large measure had been shaped and affected by the rules of

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[84] H.R. Rep. No. 1383, *supra*, p. 14.

[85] *Silver* v. *New York Stock Exchange*, *supra*, 373 U.S. at 353.

[86] H.R. Rep. No. 1383, *supra*, at p. 15.

exchanges requiring their members to charge the public fixed rates on exchange transactions.

What is at stake in the instant case, however, is not the Commission's substantive decision to eliminate the practice of fixed rates. None of the parties to this lawsuit formally disputes the propriety of such a conclusion under present circumstances. What is at stake is whether the governmental agency vested with continuing policy-making jurisdiction shall be permitted to establish national policy for the regulation of our nation's securities markets—"regulatory work for which [the Commission] was constituted . . . [and] which cries out for some rational plan" [87]—or whether that complex and delicate task shall be exercised through *ad hoc* decisions by the hundreds of district courts across this country.

But for the fact that not all of the determinations made by the Commission took the form of formal orders, the Department of Justice apparently would concur (DOJ Br. p. 48) that it is the Commission that should perform that policy-making function. The Department's limited concession, however, exalts form over substance. The Commission's authority to regulate the conduct of exchanges concerning commission rates is continuous and complete; it is the Commission, therefore, and not the antitrust courts, that most appropriately should serve as the "balance wheel," referred to by this Court in *Silver*,[88] to insure that, in

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[87] *Stork* v. *New York Stock Exchange, Inc., supra*, 346 F. Supp. at 228.

[88] 373 U.S. at 367.

evaluating the conduct of exchanges, the public interest is fully and adequately protected.

The policy articulated by the Commission to eliminate fixed exchange commission rates was derived both from the cooperative relationship Congress intended the Commission to have with the exchanges, and from the contribution of views from interested members of the public, the Department of Justice, and others. Only by sustaining the decision of the court below can it be insured that the "partnership between government and private enterprise that marks the design of the Securities Exchange Act of 1934 can operate effectively . . . in the long run."[**]

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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MARCH 1975.

I authorize the filing of this brief.

ROBERT H. BORK,
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[**] *Silver v. New York Stock Exchange, supra,* 373 U.S. at 366.

APPENDIX

The pertinent provisions of the Securities Exchange Act of 1934, 48 Stat. 881, as amended, 15 U.S.C. 78a, *et seq.*, are as follows:

NECESSITY FOR REGULATION AS PROVIDED IN THIS TITLE

SECTION 2. For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchange and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:

(1) Such transactions (a) are carried on in large volume by the public generally and in large part originate outside the States in which the exchanges and over-the-counter markets are located and/or are effected by means of the mails and instrumentalities of interstate commerce; (b) constitute an important part of the current of inter-

state commerce; (c) involve in large part the securities of issuers engaged in interstate commerce; (d) involve the use of credit, directly affect the financing of trade, industry, and transportation in interstate commerce, and directly affect and influence the volume of interstate commerce; and affect the national credit.

(2) The prices established and offered in such transactions are generally disseminated and quoted throughout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold, the amount of certain taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and the value of collateral for bank loans.

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b) hinder the proper appraisal of the value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the

effective operation of the national banking system and Federal Reserve System.

(4) National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit.

* * * * *

TRANSACTIONS ON UNREGISTERED EXCHANGES

SECTION 5. It shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange within or subject to the jurisdiction of the United States to effect any transaction in a security, or to report any such transaction, unless such exchange (1) is registered as a national securities exchange under section 6 of this title, or (2) is exempted from such registration upon application by the exchange because, in the opinion of the Commission, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the

protection of investors to require such registration.

REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SECTION 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this title, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are herein-

after collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member of conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this title or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this title shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this title and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this title and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as

a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

* * * * *

POWERS WITH RESPECT TO EXCHANGES AND SECURITIES

SECTION 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this title or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon.

(2) After appropriate notice and opportunity for hearing, by order to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to withdraw, the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this title or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such transaction any provision of this title or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission

determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.

(c) The Commission is authorized and directed to make a study and investigation of the rules of national securities exchanges with respect to the classification of members, the methods of election of officers and committees to insure a fair representation of the membership, and the suspension, expulsion, and disciplining of members of such exchanges. The Commission shall report to the Congress on or before January 3, 1935, the results of its investigation, together with its recommendations.

* * * * *

The pertinent provisions of the Sherman Act, 26 Stat. 209, as amended, 15 U.S.C. 1, *et. seq.* are as follows:

SEC. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal: * * * Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

SEC. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be

deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding fifty thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

The pertinent provisions of the Clayton Act, 38 Stat. 731, 737, 15 U.S.C. 15, 26, are as follows:

SEC. 4. That any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

SEC. 16. That any person, firm, corporation, or association shall be entitled to sue for and have injunctive relief, in any court of the United States having jurisdiction over the parties, against threatened loss or damage by a violation of the antitrust laws, including sections two, three, seven, and eight of this Act, when and under the same conditions and principles as injunctive relief against threatened conduct that will cause loss or damage is granted by courts of equity, under the rules governing such proceedings, and upon the execution of proper bond against damages for an injunction improvidently granted and a showing that the danger of irreparable loss or damage is immediate, a preliminary injunction may issue:

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under terms and conditions hereafter provided by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents here below set forth:

(1) An undertaking to comply with, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon with any provision of this Act and any amendment thereto and any rule or regulation made or to be made by the Commission thereunder.

(2) Such data as to its organization, rules of procedure and membership, and other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange."

(4) An undertaking to furnish to the Commission copies of any amendments to the documents or instruments mentioned in clause (3) of this subsection forthwith upon their adoption.

(b) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations made by the Commission thereunder and that the rules of the exchange are just and adequate to ensure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(c) The Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange within thirty days after the filing of the application, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of its filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(d) No registration shall be granted unless the rules of the exchange provide for the expulsion and suspension of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the violation of any provisions of this Act or any rule or regulation made by the Commission thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(e) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations of the Commission made thereunder and the applicable laws of the State in which it is located.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission and upon such terms as the Commission may fix, withdraw its registration.

* * * * *

SEC. 18. * * *

(c) The authority above given the Commission shall include, among other things, authority to prescribe such rules and regulations for national securities exchanges, their members and persons transacting a business in securities through such members, in addition to those specifically provided in this Act, as it may deem necessary or appropriate in the public interest or for the protection of investors, and may by its rules and regulations more specifically define the form and procedure to be followed in carrying the provisions of this Act into effect. The Commission, among other things, may prescribe the time and method of making settlements, payments, and deliveries, the time and method of calculating margin requirements, and the time and method of closing out under-margined accounts. The Commission, among other things, may by rules and regulations prescribe rules for the conduct of business on exchanges, for the classification of members, for the election of officers and committees to ensure a fair representation of the membership, for the suspension, expulsion, or disciplining of members, for the listing or striking from listing of any security with right of appeal by the issuer to the Commission, for the reporting of transactions on the exchanges and upon tickers maintained by or with the consent of any exchange, including the method of reporting short sales, sales of securities in default in bankruptcy or receivership, and sales involving other special circumstances. The Commission may fix or prescribe the method of fixing uni-

form rates of commission, interests and other charges, may prescribe minimum units of trading, rules limiting the manner, method, and place of soliciting business, rules for odd-lot purchases and sales, rules regarding minimum deposits on marginal accounts, and rules limiting or prohibiting the registration or trading in any security within a specified period after the issuance or primary distribution thereof, prescribe rules governing the carrying of accounts and to prohibit fictitious or numbered accounts and require the disclosure of the real and beneficial owners thereof. The Commission shall have power to fix the hours of trading, and, if the public interest in its opinion so requires, summarily to suspend trading in any registered security or upon any registered exchange for a period not exceeding ninety days.

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H.R. 7852

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SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under terms and conditions hereafter provided by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents here below set forth:

(1) An undertaking to comply with, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon with any provision of this Act and any amendment thereto and any rule or regulation made or to be made by the Commission thereunder.

(2) Such data as to its organization, rules of procedure and membership, and other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange."

(4) An undertaking to furnish to the Commission copies of any amenndents to the documents or instruments mentioned in clause (3) of this subsection forthwith upon their adoption.

(b) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations made by the Commission thereunder and that the rules of the exchange are just and adequate to ensure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(c) The Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange within thirty days after the filing of the application, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of its filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(d) No registration shall be granted unless the rules of the exchange provide for the expulsion and suspension of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the violation of any provisions of this Act or any rule or regulation made by the Commission thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(e) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations of the Commission made thereunder and the applicable laws of the State in which it is located.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission and upon such terms as the Commission may fix, withdraw its registration.

* * * * *

SEC. 18. * * *

(c) The authority above given the Commission shall include, among other things, authority to prescribe such rules and regulations for national securities exchanges, their members and persons transacting a business in securities through such members, in addition to those specifically provided in this Act, as it may deem necessary or appropriate in the public interest or for the protection of investors, and may by its rules and regulations more specifically define the form and procedure to be followed in carrying the provisions of this Act into effect. The Commission, among other things, may prescribe the time and method of making settlements, payments, and deliveries, the time and method of calculating margin requirements, and the time and method of closing out under-margined accounts. The Commission, among other things, may by rules and regulations prescribe rules for the conduct of business on exchanges, for the classification of members, for the election of officers and committees to ensure a fair representation of the membership, for the suspension, expulsion, or disciplining of members, for the listing or striking from listing of any security with right of appeal by the issuer to the Commission, for the reporting of transactions on the exchanges and upon tickers maintained by or with the consent of any exchange, including the method of reporting short sales, sales of securities in default in bankruptcy or receivership, and sales involving other special circumstances. The Com-

mission may fix or prescribe the method of fixing uniform rates of commission, interests and other charges, may prescribe minimum units of trading, rules limiting the manner, method, and place of soliciting business, rules for odd-lot purchases and sales, rules regarding minimum deposits on marginal accounts, and rules limiting or prohibiting the registration or trading in any security within a specified period after the issuance of primary distribution thereof, prescribe rules governing the carrying of accounts and to prohibit fictitious or numbered accounts and require the disclosure of the real and beneficial owners thereof. The Commission shall have power to fix the hours of trading, and, if the public interest in its opinion so requires, summarily to suspend trading in any registered security or upon any registered exchange for a period not exceeding ninety days.

73D CONGRESS, 2D SESSION

H.R. 8720

* * * * *

REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents below specified:

(1) An undertaking to comply, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder.

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange".

(4) An undertaking to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations made thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary, for the protection of investors, withdraw its registration.

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DISCIPLINARY POWERS OVER EXCHANGES

SEC. 18. The Commission is authorized—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw altogether the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this Act or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or an issuer of a security registered thereon;

(2) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw altogether the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations made thereunder;

(3) After appropriate notice and opportunity for hearing by order to suspend for a period not exceeding twelve months or to expel altogether from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder or has effected any transaction for any other person who as he has reason to believe is violating in respect of such transaction any provision of this Act or the rules and regulations thereunder.

(4) If in its opinion the public interest so requires, summarily to suspend trading in any registered security for a period not exceeding ten days, and with the approval of the President, summarily to suspend trading upon any registered exchange for a period not exceeding ninety days.

(5) If after appropriate request in writing to a national securities exchange that such exchange should effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested and that such changes are necessary for the protection of investors or for the insuring of fair dealing in securities traded in upon such exchange or for the insuring of fair administration of such exchange, to alter or add to the rules, regulations, and practices of such exchange in respect of such matters as the classification of members and the methods of election of officers and committees to insure a fair representation of the membership; the suspension, expulsion, or disciplining of members; safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; the listing or striking from listing of any security; hours of trading; the manner, method, and place of soliciting business; fictitious or numbered accounts; the time and method of making settlements, payments, and deliveries by members and customers; the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the

exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, in bankruptcy or receivership, and sales involving other special circumstances, the fixing of uniform rates of commission, interest and other charges; minimum units of trading; odd-lot purchases and sales, minimum deposits on margin accounts.

S. 3420

[Report No. 792]

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments

569-956—75——2

to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

* * * * *

DISCIPLINARY POWERS OVER EXCHANGES

SEC. 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this Act or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon.

(2) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such

transaction any provision of this Act or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with

the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.

(c) The Commission is authorized and directed to make a study and investigation of the rules of national securities exchanges with respect to the classification of members, the methods of election of officers and committees to insure a fair representation of the membership, and the suspension, expulsion, and disciplining of members of such exchanges. The Commission shall report to the Congress on or before January 3, 1935, the results of its investigation, together with its recommendations.

H.R. 9323

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing agreements, setting forth information, and accompanied by documents, as follows:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

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POWERS WITH RESPECT TO EXCHANGES AND SECURITIES

SEC. 18. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission shall find that such exchange shall have violated any provision of this Act or of the rules and regulations thereunder or shall have failed to enforce, so far as is within its power, compliance therewith by a member.

(2) After appropriate notice and opportunity for hearing, by order to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to withdraw, the registration of a security if the Commission shall find that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder, or has effected any transaction for any other person whom he has reason to believe is violating in respect

of such transaction any provision of this Act or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or, with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) with respect to such matters as the classification of members and the methods of election of officers and committees to insure a fair representation of the membership; the suspension, expulsion, or disciplining of members; safeguards with respect to the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; the listing or striking from listing of any security; the making available, at appropriate times

and upon reasonable terms and conditions, of the names and addresses of holders of listed securities; the manner, method, and place of soliciting business; fictitious or numbered accounts; the time and method of making settlements, payments, and deliveries, and of closing accounts; the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; the fixing of rates of commission, interest, listing, and other charges; minimum units of trading; odd-lot purchases and sales; minimum deposits on margin accounts; and similar matters.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10206/June 6, 1973

The Securities and Exchange Commission announced that it has issued an order for the institution of an investigation and public investigatory hearing, pursuant to Section 21(a) of the Securities Exchange Act of 1934, to consider whether any changes should be made in the rules, policies, practices and procedures of one or more registered national securities exchanges respecting commission rate schedules.

The Commission announced that it had received on May 31, 1973 from the New York Stock Exchange, Inc. proposed revisions of that exchange's present commission rate schedule as contained in Article XV, Section 2 of its constitution and of its Rule 383 regarding service to small investors. The May 31 submission from that exchange and the Commission's order are attached hereto.

The Exchange informed the Commission that it expects to submit a documented economic report in support of the proposed revisions within a week. That report will be available to all interested persons in the Public Reference Section, Room 100 at the Commission's Headquarters Office, 500 North Capitol Street, N.W., Washington, D.C. 20459 and at each of the Commission's regional offices. Persons who

wish to obtain a copy of that report may do so by writing to Dr. William C. Freund, Vice President and Chief Economist, New York Stock Exchange, Inc., Eleven Wall Street, New York, New York 10005.

It is the Commission's understanding that the NYSE's proposal to increase commission charges by 15% on orders from $5,000 up to $300,000 contemplates a 15% increase on the entirety of such orders rather than only on the portion of orders which exceeds $5,000. It is also the Commission's understanding that the proposed amendment to Rule 383 would enable member firms to charge small investors commissions in excess of the proposed 10% increase on orders involving from $100 to $5,000 or the proposed 15% increase on orders involving more than $5,000, i.e., the existing fixed commission on small investors' orders would become, as in the case of larger investors' orders, a minimum commission. Further, it would permit member firms to negotiate separate charges for other services rendered, such as custodial fees.

The Commission will also consider such other rule proposals as may be received from exchanges and, where appropriate, will issue a supplemental release describing them.

The Commission also announced that a public investigatory hearing on stock exchange commission rate proposals will convene at 10 a.m. Monday, July 9, 1973 at the Commission's headquarters, 500 North Capitol Street, N.W., Washington, D.C., to receive testimony and other relevant data on the foregoing NYSE commission rate proposals. The Commission has requested representatives of the NYSE to appear at that time to present testimony and relevant data and invites all other interested persons to submit their views. Persons who wish to appear and present fac-

tual material at the hearing are invited to notify the hearing officer (William E. Toomey, Room 632, Securities and Exchange Commission, 500 North Capitol Street, N.W., Washington, D.C. 20549, (202) 755–1240) of that desire as soon as possible and not later than July 9, 1973.

Witnesses will be expected to file with the hearing officer 25 copies of their prepared statements 48 hours prior to their appearance and are invited to make available additional copies at the time of their appearance for the benefit of the press and other interested persons. Other interested persons may wish to transmit written submissions for inclusion in the record in lieu of personally appearing. They should file 25 copies thereof to facilitate examination of the record by all interested persons. Such material should be submitted not later than July 23, 1973. All other communications should be filed in triplicate.

By the Commission.

RONALD F. HUNT,
Secretary.

Securities and Exchange Commission,
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10383/September 11, 1973

CONCLUSIONS OF THE SECURITIES AND EXCHANGE COMMISSION WITH RESPECT TO COMMISSION RATES

The Securities and Exchange Commission announced today its unanimous conclusions concerning the commission rate proposals of both the New York Stock Exchange, Inc. ("NYSE") and the PBW Stock Exchange, Inc. ("PBW"), which were the subject of a recent public investigatory hearing.[1] Because of their importance to public investors, the national economy and the securities industry, the Comission has determined to announce its views immediately and publish shortly its letters to the exchanges embodying the reasons for its conclusions.

New York Stock Exchange Proposals

The NYSE has proposed to increase its fixed commission rates by 10 percent on orders ranging in size from $100 to $5,000, and by 15 percent on orders ranging in size from $5,001 to $300,000. The Commission today stated its conclusions that:

(1) It will not object if the NYSE immediately should adopt the proposed rate increase effective through March 31, 1974;

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[1] *See* Securities Exchange Act Release No. 10206 (June 6, 1973); Securities Exchange Act Release Nos. 10245 (June 28, 1973) and 10337 (Aug. 10, 1973).

(2) It will not object to the continuation of such a rate increase from April 1, 1974, through April 30, 1975, if the NYSE should first adopt rules, effective by or before April 1, 1974, which (a) eliminate that portion of NYSE Rule 383 prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedule, and (b) permit, but do not require, member firms to provide less than a full range of brokerage services presently furnished customers in return for discounts of up to 10 percent from the commission rate schedule referred to in subparagraph (1), above;

(3) It will act promptly to terminate the fixing of commission rates by stock exchanges after April 30, 1975, if the stock exchanges do not adopt rule changes achieving that result; and

(4) It will not initiate in April, 1974, a break-point reduction below $300,000 respecting the portion of orders above which rates may be competitively determined.

PBW Stock Exchange Proposal

The PBW has proposed rule changes which would permit its members to offer investors a 14-day round-trip commission rate—that is, the grant of a 50 percent reduction in the commissions charged on the second transaction (either an offsetting sale or purchase) executed within 14 days of a purchase or a sale of the same security.[2] The Commission has concluded that it will object to the implementation of this round-trip commission rate proposal.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

[2] *See* Securities Exchange Act Release No. 10245 (June 28, 1973).

SECURITIES EXCHANGE ACT OF 1934

Release No. 10560/December 14, 1973

The Securities and Exchange Commission today announced that it had sent the following letter to James J. Needham, Chairman of the Board of Directors of the New York Stock Exchange, Inc., setting forth the reasons for the conclusions articulated by the Commission on September 11th with respect to, among other things, the New York Stock Exchange's proposal to increase their schedule of commission rates.

The text of the letter was as follows:

DECEMBER 14, 1973.

MR. JAMES J. NEEDHAM,
Chairman, New York Stock Exchange, Inc.,
New York, N.Y.

DEAR MR. NEEDHAM: On September 11, 1973, the Commission announced its views concerning the commission rate proposals of both the New York Stock Exchange, Inc. ("NYSE") and the PBW Stock Exchange, Inc. ("PBW").[1] At that time, the Commission stated that, because of the importance of its views to public investors, the national economy and the securities industry, the Commission had determined to announce its views immediately and subsequently to indicate the bases for them. This letter sets

[1] Securities Exchange Act Release No. 10383 (Sept. 11, 1973).

forth the reasons for the Commission's conclusions with respect to your exchange's proposal to increase commission rates and with respect to the more fundamental issue of the manner in which the commission rates charged by members of all national securities exchanges should be determined in the future.[2]

THE CONCLUSIONS EXPRESSED BY THE COMMISSION

The Commission, as you know, expressed five basic conclusions with respect to commission rates on September 11th:

(1) The Commission would not object if any national securities exchange should amend its rules immediately to increase its schedule of fixed commission rates member firms are required to charge their customers by 10 percent on orders up to $5,000 and by 15 percent on orders of more than $5,000, as had been proposed by the NYSE, nor to the continuation of those rates through March 31, 1974;

(2) The Commission will not object to the further continuation of those increased rates during the period from April 1, 1974, through April 30, 1975, by any stock exchange that adopts rules, effective on or before April 1, 1974, which

(a) eliminate that portion of NYSE Rule 383, or any comparable rule of another exchange, prohibiting member firms from charging their customers com-

[2] Although the NYSE was the only national securities exchange which formally proposed amendments to its rules designed to effect increases in its schedule of commission rate charges on the portion of all securities orders handled by exchange members not exceeding $300,000, others of the registered securities exchanges had advised us of their intention to effect increases in their commission rate schedules comparable to those proposed by the NYSE.

mission rates exceeding the exchange's commission rate schedule, and

(b) permit, but do not require, member firms to provide less than a full range of brokerage services furnished customers in return for discounts of up to 10 percent from the then effective commission rate schedule;

(3) The Commission will act promptly to terminate the fixing of commission rates by national stock exchanges after April 30, 1975, if the stock exchanges do not, on their own initiative, adopt rule changes achieving that result in advance of that date;

(4) The Commission will not, in April, 1974, initiate a breakpoint reduction below $300,000 respecting the portion of orders above which the commission rates charged by their members may be competitively determined; and

(5) The Commission expressed its disagreement with the PBW's proposal to permit its members to reduce commission rates by 50 percent on the second transaction (either an offsetting sale or purchase) executed within 14 days of a prior purchase or sale of the same security by the same person.

As noted above,[3] this letter sets forth some of the policies considered and formulated by the Commission with respect to the first four of the foregoing five conclusions articulated by the Commission on September 11, 1973, concerning commission rate schedules of national securities exchanges.

THE NYSE'S PROPOSAL TO RAISE ITS SCHEDULE OF MEMBER COMMISSION RATE CHARGES

In order to place the conclusions articulated by the Commission on September 11th in proper perspective,

[3] See p. 1, *supra*.

it is important to recognize the nature and regulatory context of the action the NYSE proposed to take.

The NYSE submitted to the Commission a proposed amendment to its rules designed to effect an increase in the commissions its members are required to charge their customers for the portion of those transactions effected on the exchange that do not exceed $300,000. This proposal had, as you are aware, been preceded by earlier NYSE proposals also designed to modify, in some manner, its rules fixing the level and rate of commissions charged by its members.

While Congress, in enacting the Securities Exchange Act in 1934, did not explicitly authorize exchanges to fix the rates of commissions their members could charge, it did implicitly recognize that national securities exchanges might fix the commissions their members are required to charge if this practice did not meet with Commission disapproval.[4] As is also true of other powers which may reside with the exchanges by virtue of the Securities Exchange Act, any power to adopt rules fixing commission rate charges is not an unfettered authority. First, the exchanges were not authorized to fix commission charges which are unreasonable. And second, Section 19(b)(9) of the Securities Exchange Act vests pervasive residual authority in the Securities and Exchange Commission to alter, modify or amend any rules or practices of exchanges fixing rates of commission and other charges, including their elimination, notwithstanding the apparent concern of

[4] Section 6(c) of the Securities Exchange Act, 15 U.S.C. 78f(c), authorizes an exchange to adopt "any rule not inconsistent with . . ." the Act or applicable state law. And Section 19(b)(9) of the Act, 15 U.S.C. 78s(b)(9), authorizes the Commission to alter, modify or amend any existing exchange rules fixing commission rates.

some members of Congress in 1934 that the Commission might abuse its authority over exchange rules fixing commission rates by causing those rates to be set too low.[5]

But, to the extent any such rules are appropriate, the promulgation of rules concerning exchange-required fixed commission rates is a matter that Congress entrusted to the exchanges in the first instance, at least as long as the fixing of commission rates should be permitted.[6] The NYSE's rate proposal was submitted to us pursuant to Securities Exchange Act Rule 17a–8, 17 CFR 240.17a–8, generally requiring that advance notice be given to the Commission by any exchange proposing to amend its rules or practices. Our consideration of the NYSE's proposal was in the context of a determination whether the Commission should take any steps preliminary to the exercise of its authority concerning the effectiveness of the NYSE's proposed action.

We have considered the reasons why the NYSE proposed to increase the level of commission rates its members must charge, as well as the authority accorded to the exchanges by the Congress in 1934, and for the reasons enumerated below, we could not conclude that the NYSE's rate proposal was unreasonable.

In support of its proposal to raise commission rates, the NYSE provided the Commission with a substantial amount of information in support of the Ex-

[5] *See, e.g.*, the remarks of Congressman Pettengill during the House floor debates on the Securities Exchange Act:

"the Commission could fix rates of commission * * * so low that no broker could stay in business and thus [the Commission could] destroy his business * * *"

78 Cong. Rec. 8091 (1934).

[6] *See* pp. 8–10, *infra*.

change's position that member firms[7] have in the last 18 months experienced increases in the prices paid for goods and services.

The Exchange attempted to measure the effect of general inflationary forces and suggested specifically that substantial increases in the cost per transaction resulting from inflationary factors alone warranted a commission rate increase in the amount the Exchange had requested.[8]

The Commission recognizes that there has been some inflation in costs since the last increase effected

[7] Reference to the NYSE member firm community is not intended to indicate any failure to consider the circumstances of the members of other registered national securities exchanges. Indeed, the Commission has considered the fact that about 30 percent of all regional stock exchange member firms and over 80 percent of American Stock Exchange member firms also are NYSE member firms and believes that financial data concerning the NYSE firms for present purposes reasonably represents the financial experience of exchange members generally. And see note 2, *supra.*

[8] The Exchange submission included an attempt to measure the degree to which inflationary forces had increased the cost of brokerage firm payrolls and other goods and services purchased by member firms, proposing that the inflationary increase in costs experienced by member firms exceeded 17 percent between April, 1970, and April, 1973.

For example, exchange estimates of increases in the cost of specific items included a 19.1 percent increase in wages and salaries, a 55.9 percent increase in other employee benefits, a 15.2 percent increase in telephone and telegraph costs and an 8.7 percent increase in rental expenses.

The Commission is persuaded that significant cost increases have in fact occurred, whether or not the effect of such increases can be demonstrated to be in the precise degree suggested by the NYSE. Such increases, of course, must be, and in fact have been, considered along with other factors in determining whether or not the anticipated results of the proposed rate increase would be unreasonable.

by the Exchange in its schedule of commission rates and that Exchange members were not in a position to pass these increased costs on to their customers, largely because of the existing fixed rate schedule applicable to the vast bulk of orders executed on national securities exchanges. The Commission is also aware that, for a protracted period, there had been a substantial decline in the volume of transactions on exchanges which aggravated the effects of the cost increases that, in fact, had occurred.[9]

The Commission finds more significant, however, the Exchange's submission of information which clearly showed that its member firm community had been experiencing severe financial losses for a substantial period preceding the rate request.

Although the profitability of NYSE member firms carrying public customer accounts, in terms of pre-tax rate of return on capital and in terms of profit margin (pre-tax return as a percentage of gross revenue) were 18.9 percent and 12.8 percent, respectively, for the full year of 1972, rates of return in the last half of 1972 had declined below their historical average levels.[10] For the first seven months of 1973, NYSE

[9] In the second quarter of 1973, the value of trading on the NYSE had declined to a level 18 percent below the level of the same period in 1972. On the AMEX, the value of trading had declined 62 percent over the same period. In the first eight months of 1973, the value of trading was down 13.2 percent on the NYSE and 55.9 percent on the AMEX from the comparable period in 1972.

[10] These data are based upon the unconsolidated pre-tax profit figures reported by such firms on their Joint Regulatory Report, a monthly report the NYSE requires its members to file with it. Data are available on a consolidated basis for the years 1965 through 1972 from the annual income and expense reports filed by NYSE member firms carrying public customer accounts.

member firms doing a public business [11] as a group, suffered pre-tax losses of $195 million on total securities activity.

This decline in profitability in the last half of 1972 and loss condition in the first seven months of 1973 was apparently experienced by firms of all types, whether regional or national, and whether serving primarily large investors or primarily small investors. Not only was there an indication that roughly one-half of the NYSE firms which carried public customer accounts were suffering such severe losses, it was also clear that, if the same level of losses that had occurred in early 1973 continued, in less than twelve months seventy-six of these firms would be unable to meet the requisite net capital requirements for doing business.

Thus, on the basis of the financial experience of the industry in late 1972, and the first seven months of 1973, it did not appear that unreasonable rates of return were likely to result if the proposed rate increase were effected by the NYSE. On the other hand, without the rate increase, the continued deterioration in the capital positions of many member firms was foreseeable, with significant capital impairment and indirect, but consequential, harm to investors the likely result.

These circumstances principally motivated the Commission to raise no objection to the NYSE's rate increase for the period ending March 31, 1974.

THE MOVE TO UNFIXED COMMISSION RATES

The Commission's conclusion that it would be appropriate to require exchanges to eliminate fixed commission rates effective by April 30, 1975, of course, also had some influence on its conclusion not to object to the specific rate increase proposed by the NYSE.

[11] This includes both firms carrying public customer accounts and introducing firms.

The Commission has consistently taken the position that the long history of fixed rates argues against a precipitous elimination of the fixed rate system. It is appropriate, for the protection of investors and in the public interest, that stock exchange firms be given an opportunity to develop business strategies and adjust their operations to a competitive-rate environment. It is not appropriate to risk the possibility that undue haste might threaten the ability of the industry to fulfill its essential function of serving the needs of investors and corporations seeking capital from the public. The severe financial experience of the member firm community in the last half of 1972 and the first seven months of 1973 indicated that, without some form of rate increase, the ability of the industry to function would be impaired at the very time that it was expected to accomplish a transition to a competitive rate system (in a relatively short period of time), as well as the implementation of an extremely large number of other regulatory initiatives of a significant nature.[12]

The Commission does not, however, view this letter as the appropriate place to articulate definitively the reasons for its conclusion that the fixing of commission rates on securities transactions should be termi-

[12] In this context, it should be noted that Senator Harrison A. Williams, Jr., Chairman of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, in his July 27, 1973, statement submitted to the Commission in its recent hearings on the NYSE's rate proposal, suggested:

"* * * that the Commission used the present public proceeding to establish a blueprint for totally eliminating fixed brokerage rates. The Commission should announce a definite date for the end of price-fixing. The date should be sufficiently distant to allow the industry to adjust and plan adequately for a competitive environment, but it should be near enough to furnish the industry, the self-regulatory organizations and the Commission with the impetus to concentrate on and pursue measures

nated by April 30, 1975. Should it become necessary for the Commission to request Exchange action in the manner prescribed by Section 19(b) of the Securities Exchange Act, however, the Commission will set forth the basis upon which it is, at that time, requesting that specified action be taken.[13]

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which hold the promise of substantially reducing costs and improving the efficiency of broker-dealer operations. Suggestions for setting such a date 12 to 18 months hence, appear to me to be reasonable.

"In the event the Commission adopts the approach I am recommending, I believe it would be entirely appropriate for it to consider increasing fixed rates during the interim period. In light of the apparently severe profit squeeze in the industry such a rate increase may well be appropriate in the public interest."

[13] The Commission is aware of the present significance to the exchanges and their member firms of its view that fixed rates be abolished. For this reason, and in order to aid the exchanges in the formulation of appropriate rules, the exchanges should be aware of the following factors which have influenced the Commission's conclusion:

(1) The Commission is concerned that the heterogeneous nature of the brokerage industry militates against applying one fixed commission rate schedule to all elements in the industry.

(2) The Commission believes that, even without fixed minimum commission rates, the advantages of best execution for customer orders and the convenience and benefits, both to brokers and customers, of clearance and other services will cause trades to be brought to the exchange market. In any event, however, the Commission is satisfied that it has the authority necessary to assure that abandonment of exchange membership is not a means to evade the investor protection obligations incident to exchange membership.

(3) The Commisson has substantial doubt whether, in fact, small investors' transactions are subsidized by fixed commission charges to institutional investors, to the extent this is suggested as a rationale for the maintenance of fixed rates.

(4) The Commission is not persuaded, as some members of the industry apparently are, that fully competitive rates would result in large firms forcing small firms out of business; small regionally-located firms have disagreed.

PREDICATES FOR THE EXTENSION OF AN INCREASE IN FIXED COMMISSION RATES FROM APRIL, 1974 THROUGH APRIL, 1975

In its release issued on September 11th, the Commission indicated its view that it would not object to the further continuation—for the period from April 1, 1974, through April 30, 1975—of the increase in Commission rates proposed by the NYSE, if the NYSE should first effect changes in its rules designed to permit an interim period during which member firms could both (1) charge up to 10 percent less than the exchange-fixed minimum rate schedule if they should provide less than the full range of brokerage services generally being furnished at the present time, and (2) charge more than the exchange-fixed minimum rate schedule if they believe such increased charges are appropriate.

We understand through conversations with representatives of the exchanges and the member firm community that there is some question whether the foregoing proposal represents a workable opportunity for experimentation with limited price competition. We adhere, however, to our objective that the exchanges take steps to effect a meaningful experimental period prior to the introduction of a system of completely unfixed commission rates, even if it should take the form of a modification of our proposal or some other realistic alternative to it. We believe the exchanges and the member firm community should assume the initiative for developing a program fostering limited price competition during this period prior to the introduction of unfixed rates if there is a desire to retain the commission rate increase that was the subject of our September 11th release beyond April 1, 1974, and we request timely initiatives by the exchanges and

other interested persons to effect this aspect of the Commission's September 11th conclusions.

LACK OF ANY NEED FOR FURTHER REDUCTIONS IN THE BREAKPOINT AT WHICH MEMBER FIRMS MAY NEGOTIATE COMMISSION CHARGES

The Commission heretofore has encouraged a program of phased reductions of the breakpoint above which member firms may competitively determine commission rate charges. The volume discounts effected by the several exchanges since 1968 at the Commission's suggestion, as well as the phased introduction of competitively-determined rates on the portion of all stock exchange orders exceeding $300,000, certainly have effected necessary changes in the exchange-fixed commission rate structure which had created certain distortions in trading activities. These changes, however, were dispositive of a number of problems raised by larger firms or institutional investors. With the experiment in limited price competition that we hope all exchanges will effect, other investors, not merely those with large orders, will have the opportunity to react to the limited range of competitive rates this next step can provide. Accordingly, the Commission has concluded that it is not necessary to initiate an April, 1974, competitive rate breakpoint reduction to a point below $300,000.

For the reasons discussed above, the Commission believes that the rate increase of limited duration, and the phasing-in of competitively determined rates during the transitional period beginning by April 1, 1974, we envision, will assist in achieving a market structure and commission rates that will better serve the interests of investors, the broker-dealer community, stock exchanges and the issuers whose securities are

traded thereon. We expect, in the spirit of cooperation that is vital to the viability of any regulatory program, that your exchange, as well as the other national securities exchanges, will timely initiate rule changes consistent with the views expressed in this letter and in our release of September 11th, 1973. We look forward to working with the NYSE and all other interested persons to achieve these ends.

For the Commission,

RAY GARRETT, JR.,
Chairman.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10670/March 7, 1974

ANNOUNCEMENT IN RESPONSE TO COMMISSION RATE PROPOSALS

The Commission announced today that it has responded to the New York Stock Exchange's proposals to initiate a program for limited price competition commencing April 1, 1974 on non-member orders involving up to $2,000 and to rescind existing prohibitions against charging, on orders involving more than $2,000, commissions in excess of the rates provided in stock exchange commission schedules. Further, the Commission responded to an NYSE request that minimum intra-member rates for floor brokerage and clearance functions be retained on orders not exceeding $2,000 and that a public investigation be made of the likely effects of introducing intra-member competitive rates for execution and clearance. The Commission stated that pending further study of, and solicitation of the public's views and comments on, whether current rules fixing intra-member rate charges prevent an adequate experiment with limited price competition, it would not object to implementation, by April 1, 1974, of the limited unfixing of non-member rates described above. The text of the Commission's letter follows:

MR. JAMES J. NEEDHAM,
Chairman, New York Stock Exchange, Inc.,
New York, N.Y.

DEAR MR. NEEDHAM: This is in response to the letters of the New York Stock Exchange ("NYSE"), dated February 7 and 21, 1974, which submitted to us, pursuant to Securities Exchange Act Rule 17a–8, 17 CFR 240.17a–8, proposed amendments to the NYSE's Constitution and Rules respecting commission rates. These letters responded to the statement in our letter of December 14, 1973, to the NYSE, that "the exchanges and the member firm community should assume the initiative for developing a program fostering limited price competition during "the period between April 1, 1974, and April 30, 1975. Accordingly, the NYSE's February 7th letter proposed amendments to Article XV of its Constitution, which would:

(1) provide for competitive non-member and intramember commission rates on all orders not exceeding $2,000; (2) rescind the prohibition now set forth in NYSE Rule 383 against charging commissions exceeding the existing exchange schedule of minimum rates applicable to orders exceeding $2,000; and (3) otherwise rescind NYSE Rule 383.

In its letter of February 21, the NYSE modified its original suggestions for Constitutional and Rule changes by deleting its proposed amendments respecting intramember rates for floor brokerage and clearance functions on orders not exceeding $2,000 (Sections 2(b) and 2(c) of Article XV of the NYSE Constitution). In this regard, the NYSE stated that no study has been made of the likely effects of intramember competitive rates and requested the Commission to conduct an investigation of this matter.

Pending further study of, and solicitation of the public's views and comments on, the question whether

the retention of your current rules fixing intramember rate charges for orders not exceeding $2,000 prevents the adequate experiment with limited price competition in which we previously indicated the exchanges should engage, we will not raise any objection if the NYSE should effect the rate proposals set forth in its letter of February 21. If the Commission determines, as a result of its study of the matter, that exchange experiments with limited price competition should be broadened to encompass intramember rates, we expect that you promptly will implement any necessary rule and consitutional changes.

The Commission appreciates the NYSE's timely efforts to begin a constructive experiment with limited price competition on April 1, 1974.

Sincerely,

RAY GARRETT, JR.,
Chairman.

Securities and Exchange Commission,
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10751/April 23, 1974

NOTICE OF PUBLIC HEARING ON INTRA-MEMBER COMMISSION RATE SCHEDULES OF REGISTERED NATIONAL SECURITIES EXCHANGES

The Securities and Exchange Commission today announced that a public investigatory hearing, ordered pursuant to the Commission's authority under the Securities Exchange Act of 1934 ("Exchange Act"), including, but not limited to, Exchange Act Section 21(a), 15 U.S.C. Section 78u(a), will be held beginning May 29, 1974 to receive oral and written comments, views and data concerning whether any changes should be made in the rules, policies, practices and procedures of registered national securities exchanges prescribing minimum rates of commission for business performed by one member for another ("intra-member rates"). The hearing will convene at 10 a.m., Wednesday, May 29, 1974, in Room 776 at the Commission's headquarters, 500 North Capitol Street, Washington, D.C. 20549.

In Exchange Act Release No. 10383 (September 11, 1973), the Commission announced its determination not to object to the proposal of the New York Stock Exchange, Inc. ("NYSE") to increase by 10 percent its fixed commission rates on non-member orders ranging in size from $100 to $5,000, and by 15 percent

on non-member orders ranging in size from $5,001 to $300,000. The Commission also announced in that Release that it would initiate action to terminate the fixing of commission rates by securities exchanges after April 30, 1975 if the exchanges have not amended their rules to effect such termination by that date and that, in order for the rate increase to continue from April 1, 1974 through April 30, 1975, the NYSE should adopt a program of rule changes, effective on or before April 1, 1974, which (a) eliminate that portion of NYSE Rule 383 prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedule and (b) permit members to engage in a limited but adequate experiment in competitive commission rates. These conclusions were applied also to every exchange which adopted, and desired to continue in effect, the 10 percent and 15 percent commission rate increases. In Exchange Act Release No. 10560 (December 14, 1973), the Commission requested the exchanges to initiate timely development of such a program of rule changes.

In a letter dated February 7, 1974, the NYSE submitted to the Commission proposed amendments to its constitution and rules to rescind Rule 383, to provide for competitive commissions on both member and non-member orders of $2,000 or less and to rescind the prohibiton against charging commissions exceeding minimum rates. By letter dated February 21, 1974, the NYSE modified its proposal by withdrawing those of its proposed amendments which would have subjected intra-member commission rates to competition on orders of $2,000 or less.

In its letter, the NYSE also stated the following:

> The Exchange does not believe, however, that it is necessary to amend those provisions of the Constitution dealing with floor brokerage and

clearance (Article XV, Sections 2(b) and 2(c)) in order to provide the experimentation sought by the Commission in its letter of December 14, 1973. No study has been made of the likely impact in the intra-member competitive rates, but quite clearly this impact might be unexpectedly severe on those members and member organizations which are largely dependent on these floor brokerage and clearance rates. A serious erosion in floor brokerage income could have a harmful impact on the essential market making function of specialists.

The Board of Directors is not aware that there has been any meaningful accumulation of data on an industry wide basis as to the possible impact of negotiated intra-member rates. Because of the importance of this question with regard to the restructuring of the industry, the Board of Directors urges the Commission to conduct a public investigation of this matter pursuant to Section 21 of the Securities Exchange Act of 1934. This procedure would enable all interested parties to be heard and should provide the essential information needed to make an appropriate determination of this question. The Board urges that this procedure be initiated promptly so that it be completed well in advance of April 30, 1975.

In Securities Exchange Act Release No. 10670 (March 7, 1974), the Commission responded to the NYSE's modified proposals, stating:

Pending further study of, and solicitation of the public's views and comments on, the question whether the retention of your current rules fixing intramember rate charges for orders not exceeding $2,000 prevents the adequate experiment with limited price competition in which we previously indicated the exchanges should engage, we will not raise any objection if the NYSE should effect the rate proposals set forth

> in its letter of February 21. If the Commission determines, as a result of its study of the matter, that exchange experiments with limited price competition should be broadened to encompass intramember rates, we expect that you promptly will implement any necessary rule and constitutional changes.

Somewhat similar statements respecting intra-member rates were received from, and corresponding replies were sent to, other stock exchanges in connection with their proposals to implement, by April 1, 1974, the same limited experiment in competitive commission rates.

Interested persons who desire to appear or to submit written comments, views or data in this matter may wish to review materials submitted in the investigatory hearings conducted by the Commission in 1970 and 1971 concerning the reasonableness of, and the need for, minimum intra-member rates. These materials are contained in the following documents, which are available for inspection in the Commission's Public Reference Section, Room #6101, 1100 "L" Street, N.W., Washington, D.C. 20005 (copies of the hearing transcripts listed below may also be available in the Commission's regional offices):

Hearing Transcripts

In the matter of Commission Rate Schedules of Registered National Securities Exchanges:

File No. 4–144–1–17, July 20, 1970, Pages 5996–6037;

File No. 4–144–1–18, July 21, 1970, Pages 6188–6199 and Pages 6205–6208;

File No. 4–144–1–22, July 12, 1971, Pages 7279–7295;

File No. 4–144–1–22, July 13, 1971, Pages 7551–7586 and Pages 7594–7597; and

File No. 4–144–1–22, July 14, 1971, Pages 7599–7606 and Pages 7622–7625.

Exhibits

In the matter of Commission Rate Schedules of Registered National Securities Exchanges:

File No. 4–144–1–10 (NYSE). Exhibit 29–A—"Report on New Commission Rate Schedule" dated July 13, 1970, Pages 19–20.

File No. 4–144–1–14 (NYSE). Exhibit 71–1—"Report on New Minimum Commission Rate Schedule" dated July 12, 1971, Pages 21–26.

The purpose of the hearing is to gather comments, views and data concerning whether the initiation in the near future of a limited experiment in competitive intra-member rates of commission on orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists, and whether it is necessary or appropriate in the public interest or for the protection of investors for exchanges to maintain any prescribed schedules of intra-member rates of commission. It will be necessary, if such schedules of intra-member rates are to be retained, for the Commission to have a basis upon which to judge the reasonableness of such rates. The following questions are intended to elicit such information. Persons who wish to offer oral or written statements for the record of the hearings are invited to comment on the following questions and other matters related to intra-member rates.

(1) What reason is there to conclude that an experiment until April 30, 1975 in competitive intra-member rates for orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists? If members without their own floor brokers ("off-

floor members") are competitively disadvantaged as against vertically-integrated members (*i.e.*, members having their own floor brokers) by the present fixing of intra-member rates (see question (12)), will permitting fixed intra-member rates on orders not exceeding $2,000 during the period of experimentation with competitive non-member rates on such transactions, exacerbate the competitive disadvantage of off-floor members or, as between off-floor members and vertically-integrated members, cause statistically biased results respecting competitive non-member rates?

(2) Are intra-member rate schedules for (a) clearance services or (b) floor brokerage services necessary or appropriate for the protection of investors, or to insure fair dealing in securities traded upon an exchange, or to insure fair administration of an exchange?

(3) Assuming it is necessary or appropriate to have intra-member rate schedules for clearance functions, should such rates be higher than the clearing fees charged by a clearing corporation for direct mail clearance? Should they be different for orders effected for the member's own account than for orders effected by such member for other persons? (Compare Sections 2(b) and 4 of Art. XV of the NYSE Constitution.)

(4) Should intra-member rate schedules for execution be applicable to

(a) orders left with specialist (or, in the case of the Chicago Board Options Exchange, board brokers),

(b) services provided by a floor broker not acting as a specialist, or

(c) both?

(5) Should intra-member rate schedules for floor brokerage be different for different types of orders

(*e.g.*, market orders, limited price orders, percentage orders, not-held orders)?

(6) Should a member who provides execution and clearance services for other members and for non-member brokers be prohibited from lowering its prices if it believes such action is necessary to retain the business it receives from correspondents?

(7) Assuming it is necessary or appropriate for exchanges to retain intra-member rate schedules for floor brokerage, what standards should be used to determine their reasonableness? Please answer the following questions separately for (a) floor brokers not acting as specialists and (b) specialists, and explain whether your answers would differ depending on whether the intra-member rate schedules would provide for a minimum rate with no maximum, a fixed rate which is both a minimum and a maximum, or a maximum rate with no minimum:

(i) What expenses should be allowable in determining floor brokerage rates?

(ii) Should rate of return on investment be the standard used to determine the reasonableness of levels of profitability? If so, what should be the base of the rate of return, *i.e.*, equity capital or equity and debt capital?

(iii) What rate(s) of return should be allowed?

(iv) In order to provide excess floor brokerage capacity (if that is needed), must rates for floor brokerage be more than "economic cost-remunerative" (cover more than costs plus reasonable profit), or, absent such subsidy, would the number of available floor brokers increase quickly enough to accommodate sudden increases in demand? If excess capacity for floor brokerage services is needed, how much is needed and can it be supplied at lower cost by the automation of certain types of orders?

(v) Do intra-member rate schedules for floor brokerage which are more than economic cost-remunerative, or which compensate for maintaining excess capacity, unduly inhibit the automation of floor brokerage services?

(vi) Can costs and capital of non-specialist floor brokers be allocated among agency activities and their other activities? If so, how? If a member engages generally in the securities business in addition to providing floor brokerage services, should costs and capital be allocated between floor brokerage done for that member's own organization and that done for other member organizations?

(vii) Can costs and capital of specialists be allocated among specialists' broker functions, dealer functions and their other activities?

(viii) Should the standards for measuring the reasonableness of costs and rates of return differ in formulating intra-member rate schedules for specialists and for floor brokers?

(8) If exchanges are to retain schedules of intra-member rates of commission for specialists,

(a) should the specialist receive all or part of the intra-member rate for floor brokerage when he acts as broker with respect to an order left on his book? (Compare NYSE Constitution Art. XV, Section 2(c), which provides for payment of the full intra-member floor brokerage rate on that exchange to the specialist when he acts as broker for an order left with him, and American Stock Exchange, Inc. ("Amex") Constitution Art. VI, Section 2(c), which provides under similar circumstances for payment of approximately ¾ of the intra-member rate for floor brokerage to the specialist, leaving approximately ¼ for retention by the floor broker.)

(b) should the answer to (a) differ if the specialist acts as dealer with respect to such an order? (Compare the above NYSE and Amex constitutional provisions with Midwest Stock Exchange Article XXVIII, Rule 22.)

(9) Should intra-member rates paid to specialists on orders left with them be more than economic cost-remunerative in order to subsidize the specialist's dealer obligation? If so, can the amount of subsidy be calculated (and periodically adjusted) to do no more than subsidize the dealer obligation to the extent such a subsidy is required?

(10) (a) Assuming that the quality of specialists' dealer performance *can* be objectively evaluated,

(i) should floor brokerage income from the execution of orders left with all specialists on an exchange be pooled and then allocated by the exchange to specialists on the basis of performance?

(ii) if there is no pooling of floor brokerage income, should an exchange structure its schedule of rates so that a high-rated specialist would receive a larger portion of the floor brokerage income from orders left with him than he would if he were low-rated?

(iii) if there is no pooling of floor brokerage income and no differentiation in the amounts paid to specialists on the basis of their ratings, should an exchange reallocate stocks among specialists from time to time to reinforce high standards of specialist performance?

(iv) to what extent, if any, should any allocation of pooled floor brokerage income, or differentiation in amounts paid to specialists on the basis of their ratings, or periodic reallocation of stocks, take into account a specialist's profitability, or lack thereof, in addition to his dealer performance rating?

(v) to what extent, if any, should any allocation of pooled floor brokerage income, or differentiation in amounts paid to specialists on the basis of their ratings, or periodic reallocation of stocks be designed to achieve a subsidy of specialists' dealer activity in less profitable stocks?

(b) Could a prescribed intra-member rate for specialists' floor brokerage services which included an amount intended to subsidize the specialists' dealer functions meet the tes of reasonableness if the quality of specialists' dealer performance *cannot* be objectively evaluated?

(11)(a) Does assignment by an exchange of the book to one specialist confer an undue competitive advantage upon him over other market makers on and off such exchange who would be willing to share the specialist's dealer obligations if they participated in his subsidy?

(b) If liquidity with depth is provided by competing market makers on or off an exchange (other than the exchange specialist) and the exchange retains intra-member rates for specialists which include a subsidy,

(i) should provision be made for such other market makers to receive a portion of the subsidy, and should the answer depend upon whether they supply such liquidity with depth for competitive reasons, or pursuant to their assumption of affirmative obligations; or

(ii) should each such market maker (including the specialist) have his own book and corresponding subsidy? If so, under what conditions?

(12) Do intra-member rates which are more than economic cost-remunerative place off-floor members at a competitive disadvantage as against vertically-integrated members? If intra-member rates on limit orders

left with specialists are not to be merely economic cost-remunerative but, as a matter of policy, are to include a subsidy for the specialist's market-making function, can intra-member rates for floor brokerage be the same for floor brokers as for specialists without competitively disadvantaging off-floor members?

(13) Assuming that the specialist's dealer function should be subsidized through intra-member rates on orders left with specialists and that excess floor brokerage capacity should be subsidized through separate intra-member rates for floor brokerage, will each of these assumed needs result in identical intra-member rates for specialists' agency sevices and for floor brokers' services? If the two have different costs or capital requirements, should exchange-mandated intra-member rates for agency services nevertheless be the same? If the intra-member were to be different for agency services provided by specialists and floor brokers, or were to be prescribed in the case of one but not the other, would this produce results inconsistent with the protection of investors, fair dealing or fair administration of the exchange?

(14) Various securities exchanges impose charges and fees, payable by one member to another member, for services other than traditional floor brokerage and clearance. For example, when a market-maker member on the PBW Stock Exchange, Inc. effects a principal transaction in one of the stocks in which he is registered with that exchange as an alternate specialist, he must pay 1¢ per share to the regular specialist in that stock (Rule 459). On the Midwest Stock Exchange, Incorporated a member (who is not a specialist) who deals as principal with another member is entitled to receive from that other member a fee equal to the rate of floor brokerage (Art. XXVIII, Rule 22). Are such required fees and charges necessary or appropri-

ate? What standards should be used to determine the reasonableness of such fees and charges?

Persons who wish to appear at the hearing are requested to notify the hearing officer, William E. Toomey, Room 632, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, telephone number (202) 755–1240, as soon as possible.

Persons intending to appear should file 25 copies of the text of their prepared oral statements with the hearing officer 48 hours prior to their appearance and are invited to make additional copies of their statements available at the time of their appearance for the benefit of the press and all other interested persons.

Persons wishing to submit written statements for the Commission's consideration, in lieu of appearing personally, should file 25 copies thereof no later than June 14, 1974.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10986/Aug. 27, 1974

ANNOUNCEMENT OF PLANS TO EFFECT THE ELIMINATION OF RULES OF NATIONAL STOCK EXCHANGES FIXING COMMISSION RATES

The Securities and Exchange Commission today announced that it plans promptly to initiate steps concerning the amendment, modification, alteration or repeal of the existing rules and practices of the national securities exchanges registered with the Commission pursuant to Section 6 of the Securities Exchange Act of 1934,[1] requiring exchange members to charge fixed rates of commission on securities transactions effected on exchanges.

The Commission is issuing this release in view of the questions that have been raised concerning the procedures to be followed by the Commission and the national securities exchanges in this regard.

On September 11, 1973,[2] the Commission announced its policy conclusion that exchange rules and practices requiring members to charge fixed rates of commission on securities transactions effected on an ex-

[1] 15 U.S.C. 78f.

[2] *See* Securities Exchange Act Release No. 10383.

change should be eliminated.[3] In its announcement, the Commission expressed its view that the elimination of such rules and practices should be effective no later than May 1, 1975.

In this context, the Commission today announced that, pursuant to the authority vested in it under the Securities Exchange Act, and particularly Sections 2, 6, 10, 11, 19 and 23 thereof,[4] it would send a letter to the president of each national stock exchange during September, 1974, asking them to alter, amend or modify existing exchange rules and practices which presently require, or have the effect of requiring, their members to charge fixed rates of commission, unless action on their part should make this unnecessary.

In the event that any or all of the exchanges decline to take such action voluntarily, the Commission will commence appropriate proceedings promptly to determine whether it should exercise its authority to effect modifications, alterations or amendments in existing exchange rules and practices relating to the fixing of commission rates.

The Commission's prior discussion of its views indicated its preference for voluntary exchange efforts to achieve a system of unfixed commission rates. Nevertheless, the Commission recognizes that there may be differences of view concerning whether, how and when to achieve such a system of unfixed commission rates on exchange transactions. For that reason, unless exchanges voluntarily take prompt steps to eliminate fixed commission rates, the Commission

[3] Further elaboration of the policy considerations underlying the Commission's determinations with respect to exchange rules and policies requiring members to charge fixed commission rates is set forth in Securities Exchange Act Release No. 10560 (Dec. 14, 1973).

[4] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

intends to afford all interested persons an opportunity to submit both written and oral data and views in order to facilitate a thorough consideration of this issue. In light of the prior study that has been given to the question of eliminating the present structure of fixed commission rates for securities transactions effected on exchanges,[5] however, it is the Commission's intention expeditiously to conclude any hearings which may be required.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

[5] Since 1968, the Commission and the Congress have expended a great deal of time and effort in studying the structure of commission rate charges on exchange-effected securities transactions. *See, e.g., In the Matter of SEC Rate Structure Investigation of National Securities Exchanges*, Commission File No. 4–144 (1968–1971); Subcommittee on Commerce and Finance of the House of Representatives Committee on Interstate and Foreign Commerce, 92d Cong., 1st and 2d Sess. *Securities Industry Study*, Parts 1–9 (1971–1972); Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 1st and 2d Sess., *Securities Industry Study* (1971–1972).

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 11019/September 19, 1974

ANNOUNCEMENT OF WRITTEN REQUESTS CONCERNING COMMISSION RATES SENT TO REGISTERED NATIONAL SECURITIES EXCHANGES

The Securities and Exchange Commission today announced that it had sent the following letter to all registered national securities exchanges:

DEAR [PRESIDENT OF EACH REGISTERED NATIONAL SECURITIES EXCHANGE]: As you are aware, the Commission, on September 11, 1973,[1] announced its policy conclusion that the fixing of commission rates by national securities exchanges should terminate after April 30, 1975. This conclusion followed ten years of special studies, Commission public investigatory hearings and policy statements, Congressional hearings and reports, studies by consultants for the New York Stock Exchange and publications by scholars concerning this practice.[2]

[1] *See* Securities Exchange Act Release No. 10383. The Commission's policy conclusions were discussed in more detail in a separate letter to the New York Stock Exchange, reprinted as Securities Exchange Act Release No. 10560 (Dec. 14, 1973).

[2] *See, e.g.*, Securities and Exchange Commission, *Institutional Investor Study Report*, H.R. Doc. No. 92-64, 92d Cong., 1st Sess. (1971); Securities and Exchange Commission, *Report of Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963); Securities and Exchange Commission, *Report on the Public Policy Implications of Investment*

The Commission, however, has consistently taken the position that the long history of fixed rates argued against a precipitate elimination of the fixed rate sys-

Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966); and Wharton School of Finance and Commerce, *A Study of Mutual Funds*, H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962).

In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–171; *In the Matter of the Structure, Operation and Regulation of the Securities Markets*, Securities and Exchange Commission File No. 4–147; *In the Matter of Commission Rate Structure of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–144.

See Securities and Exchange Commission, *Policy Statement on the Structure of a Central Market System* (1973); and Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets* (1972).

See, e.g., Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess. *Report of the Securities Industry Study*, S. Doc. No. 93–13 (1973); Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess., *Report of the Securities Industry Study for the Period Ending February 4, 1972* (1972); *Hearings on Securities Industry Study Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 92d Cong., 1st Sess. (1972); Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 92d Cong., 1st and 2d Sess., *Report of the Securities Industry Study* (1971–1972).

National Economic Research Associates, Inc., *Stock Brokerage Commissions: The Development and Application of Standards of Reasonableness for Public Rates. A Report to the Cost and Revenue Committee of the New York Stock Exchange* (July 1970); National Economic Research Associates, Inc., *Reasonable Public Rates for Brokerage Commissions, A Report to the Cost and Revenue Committee of the New York Stock Exchange* (Feb. 1970).

See, e.g., Friend and Blume, *The Consequences of Competitive Commissions on the New York Stock Exchange* (1972).

tem and that it was appropriate, therefore, for the protection of investors and in the public interest, that exchange members be given an opportunity to develop business strategies for, and to adjust their operations to, an unfixed rate environment.

That opportunity has been provided. Commission schedules of exchanges have provided for volume discounts since December, 1968.[3] Commissions on portions of orders exceeding $500,000 have been competitively determined since April, 1971,[4] and those exceeding $300,000 have been competitively determined since April, 1972,[5] and, those with respect to nonmember commissions on orders of $2,000 or less, since April, 1974.[6]

Subsequent to the Commission's announcement of its policy conclusions on September 11, 1973, and in response to a request from the New York Stock Exchange, Inc., the Commission held a public investigatory hearing concerning fixed intramember rates on exchanges.[7] The Commission is not persuaded, on the basis of the data and views obtained as a result of that hearing and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intramember rates. The Commission has also determined not to exercise its authority to require any fur-

[3] *See* Securities Exchange Act Release Nos. 8324 (May 28, 1968), and 8399 (Sept. 4, 1968).

[4] *See* Securities Exchange Act Release Nos. 9105 (Mar. 11, 1971) and 9132 (Apr. 1, 1971).

[5] *See* Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets*, *supra* n. 2, at p. 16.

[6] *See* Securities Exchange Act Release No. 10560 (Dec. 14, 1973).

[7] *See In the Matter of Intra-Member Commission Rate Schedule of Registered National Securities Exchanges*, *supra* n. 2.

ther experimentation with unfixed intra-member rates prior to May 1, 1975. It will, however, welcome any initiative by any exchange to provide additional experimentation on floor brokerage rates prior to April 30, 1975.[8]

As a result of these studies and hearings, it presently appears to the Commission that it is necessary and appropriate (1) for the protection of investors, (2) to insure fair dealing in securities traded in upon national securities exchanges, and (3) to insure the fair administration of such exchanges, that the rules and practices of such exchanges that require, or have the effect of requiring, exchange members to charge any person fixed minimum rates of commission, should be eliminated. Accordingly, the Commission hereby formally requests, pursuant to the authority vested in it under the Securities Exchange Act of 1934, and particularly Sections 2, 6, 10, 11, 19 and 23 thereunder,[9] that you effect necessary changes in the Constitution, rules and practices of your exchange which presently require, or have the effect of requiring, any member of your exchange to charge any person any fixed commission rate, with such changes to be effective on or before May 1, 1975.

Because we believe the interests of public investors require the prompt implementation of the above-described Constitutional, rule and practice changes, we request that your Board of Directors approve the requested changes no later than November 1, 1974,

[8] The Commission will act promptly on any submission by the New York Stock Exchange of the proposal, discussed in the course of our Intra-Member Rate Hearings, n. 2, *supra*, to eliminate fixed minimum commission rates for clearance (Sections 2(b) and 4, Article XV, of the NYSE Constitution).

[9] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

with such changes to become effective, after appropriate exchange procedures, not later than May 1, 1975. If the boards of directors of all of the national securities exchanges registered with the Commission do not take such action on or before November 1, 1974, the Commission will commence appropriate proceedings promptly to determine whether it should exercise its authority to alter or amend the Constitutions, rules and practices of such exchanges in the manner described above. In that event, as you previously have been advised,[10] the Commission will afford you and other interested persons an opportunity to submit both written and oral data and views in order to facilitate the Commission's consideration of whether to exercise its authority in this matter and whether to exercise it in the manner specified above. The procedures for that purpose would be specified prior to the commencement of any such proceeding.

For the Commission.

Sincerely,

RAY GARRETT, JR.,
Chairman.

The letters were sent to the American Stock Exchange, Inc., Boston Stock Exchange, Chicago Board Options Exchange, Inc., Chicago Board of Trade, Cincinnati Stock Exchange, Detroit Stock Exchange, Midwest Stock Exchange, Inc., National Stock Exchange, New York Stock Exchange, Inc., Pacific Stock Exchange, Inc., PBW Stock Exchange, Inc., Intermountain Stock Exchange and Spokane Stock Exchange.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

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[10] *See* Securities Exchange Act Release No. 10986 (Aug. 27, 1974).

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 11073/October 24, 1974

PROPOSAL TO ADOPT SECURITIES EXCHANGE ACT RULES 19B–3 AND 10B–22 (4–176)

The Securities and Exchange Commission today released for public comment proposed Securities Exchange Act Rules 19b–3 and 10b–22. The rules would be adopted under the Securities Exchange Act of 1934 (the "Act"), and particularly Sections 2, 6, 10, 11, 19 and 23 thereunder, 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w. In that connection, the Commission also announced that it would hold oral hearings beginning Tuesday, November 19, 1974, at 10 a.m., in Room 776 at the Commission's headquarters, 500 North Capitol Street, Washington, D.C. 20549.

Introduction

On September 19, 1974, the Commission requested national securities echanges to effect necessary changes in their constitutions, rules and practices so as to eliminate those elements that require, or have the effect of requiring, exchange members to charge any person any fixed rate of commission.[1] While the Commission has not received responses from all na-

[1] Securities Exchange Act Release No. 11019 (Sept. 19, 1974), 39 Fed. Reg. 35214 (Sept. 30, 1974).

tional securities exchanges, only one such exchange has indicated that it would comply with the Commission's request,[2] and three such exchanges have indicated that they do not intend to comply fully with the Commission's request.[3] Accordingly, the Commission has determined to publish for comment proposed Rule 19b–3 which would alter and supplement the rules of national securities exchanges by prohibiting national securities exchanges from adopting or retaining any rule of the exchange that requires, or from otherwise directly or indirectly requiring, members to charge

[2] The Intermountain Stock Exchange has so indicated; in addition, while the Cincinnati Stock Exchange has not yet responded to the Commission's request, it took action in July, 1974, to eliminate fixed intra-member rates.

[3] The American, Boston and New York Stock Exchanges have so indicated. The Amex has indicated that, after giving detailed consideration to the Commission's request and to the question of uniform versus negotiated commission rates, it (1) would seek a hearing to present the Amex's position on the need to retain uniform commission rates and (2) had determined that it could not accede voluntarily to the Commission's request. The Amex has accordingly requested an opportunity to submit to the Commission its written and oral views.

The NYSE has indicated that it believes that competitive rates without concurrent legislative and regulatory safeguards would ultimately be destructive of the auction market and not in the public interest. The NYSE has, therefore, indicated it would comply with the Commission's request insofar as it relates to public commission rates, but only if a combined program of legislation and regulation is enacted consistent with the intent of the NYSE's policy statement of March 1, 1973, which among other things, would require that all trades of listed securities be exposed to the flow of orders in an auction market prior to exposure to other markets. It has, however, declined to comply with the Commission's request insofar as it relates to floor brokerage commission rates. Since the combined program has not, in the NYSE's view, been enacted, the NYSE has also requested a hearing.

any person any fixed rate of commission for transactions executed on, or effected by use of the facilities of, such exchanges. In addition, Rule 19b–3 would require exchanges to provide in their rules that nothing therein or in the practices of exchanges shall be construed to require or permit members to agree or arrange, directly or indirectly, for the charging of fixed rates of commission. Rule 19b–3 would also relieve exchange members and their associated persons of the obligation to comply with any exchange rule covered by paragraph (a) of Rule 19b–3 regardless of whether the exchange had amended or repealed such rule; members and associated persons could also no longer rely on such an exchange rule.

In addition, the Commission has determined to publish for comment proposed Rule 10b–22 which would make it unlawful for any broker, dealer or member of any national securities exchange, directly or indirectly, to participate in any agreement or arrangement with another broker, dealer or member of any exchange with respect to the fixing of any amount to be charged to other persons in respect of transactions in securities executed on, or effected by using any facility of, such exchange. Proposed Rule 10b–22 would, however, not affect participation in agreements or arrangements in respect of transactions in securities which are exempted from Rule 10b–2 by paragraph (d) thereof or are made in compliance with the provisions of Rule 10b–7 or Rule 10b–8. Under section (c) of the proposed rule, the Commission, having due regard for the public interest and for the protection of investors, and in order to insure the maintenance of fair and honest markets, could grant exemptions, either upon written request or upon its own motion, and could impose upon any exemption so granted such terms and conditions as it deemed necessary or ap-

propriate in the public interest or for the protection of investors. Proposed Rule 10b–22 is intended to prevent circumvention of proposed Rule 19b–3 and, accordingly, would only be adopted if proposed Rule 19b–3 is adopted.

Commission concern with the operation of rules prescribing fixed commission rates for exchange transactions spans more than a decade of hearings and studies;[4] transitional changes in the historical fixed commission rate structure began in 1968[5] and have continued over a period of six years, reflecting the Commission's determination to devise gradual solutions which would be consistent with the protection of investors and the public interest; and the Commission's policy conclusions to act to terminate the fixing of commission rates have been a matter of public record for more than a year.[6] Nevertheless, before adopting rules to eliminate the fixing of commission rates, the Commission is undertaking to review all issues involved (including issues relating to the third market and such other issues as the exchanges and other interested persons believe should be covered) as well as to consider carefully any collateral consequences that might result from the elimination of fixed rates. Furthermore, it may be appropriate to consider

[4] Materials relating to such hearings and studies, as well as some of the other source materials which may prove useful to interested persons in submitting views, data and arguments with respect to the rules proposed today are listed, *infra*. The Commission will make available shortly a synopsis of action previously taken by the Commission relating to fixed commission rates on exchange transactions.

[5] *See* Securities Exchange Act Releases Nos. 8324 (May 28, 1968) and 8399 (Sept. 4, 1968).

[6] *See* Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973).

whether alternative or additional regulations should be provided under the Act.

Therefore, in addition to soliciting the submission by interested persons of written views, data and arguments, which should be submitted no later than December 10, 1974, the Commission will hold oral hearings beginning on November 19, 1974, to obtain oral presentations of views and data and arguments. The Commission will invite representatives of the national securities exchanges, member firms and other organizations in the securities industry as well as other interested persons to appear at the oral hearings. The Commission will welcome requests from other persons to appear and, subject to time limitations, will accommodate as many such persons as possible.

It is anticipated that the oral hearings will also prove a useful adjunct to the rulemaking proceeding. Nevertheless, in order to facilitate the widest possible public participation, copies of all written submissions, as well as transcripts of the oral hearings, will be made available in the Public Reference Room, 1100 L Street, N.W., Washington, D.C., and at each regional office of the Commission. Persons wishing to submit written views, data and arguments in respect of submissions made by others or in respect of views, data and arguments presented at the oral hearings may do so until December 24, 1974.

Proposed Rule 19b–3

The text of proposed Rule 19b–3 is as follows:

Rule 19b–3. Prohibiting Fixing of Rates of Commission by Exchanges

(a) Effective May 1, 1975, no national securities exchange ("exchange") shall adopt or retain any rule of the exchange that requires,

or shall otherwise, directly or indirectly, require its members, or any person associated with its members, to charge any person any fixed rate of commission for transactions executed on, or effected by the use of the facilities of, such exchange.

(b) Each exchange shall provide effective May 1, 1975, in its rules of the exchange that nothing therein or in its practices shall be construed to require or permit its members, or any person associated with its members, to agree or arrange, directly or indirectly, for the charging of fixed rates of commission for transactions executed on, or effected by the use of the facilities of, such exchange.

(c) On and after May 1, 1975, no member of any exchange, or person associated with any member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange covered by paragraph (a) of this rule.

(d) As used in this rule, the term "rule of the exchange" refers to any provision of the constitution, articles of incorporation, bylaws or rules or instruments corresponding thereto, whatever the name, of the exchange.

If adopted, proposed Rule 19b–3 would by its terms become effective on May 1, 1975.

Proposed Rule 19b–3 is intended to reach all rules governing the fixing of rates of commission on exchange transactions. Thus, for example, in the case of the NYSE, the provisions of Article XV of the NYSE Constitution could not be retained after May 1, 1975; the rule specifically covers intra-member rates as well as rates charged to non-members. In addition, other rules, such as NYSE Rules 391, 392 and 393, would have to be amended by exchanges to eliminate provisions intended to preserve the fixed commission rate structure in connection with distributions outside of the normal pattern of exchange transactions. Pro-

posed Rule 19b–3 covers any "rule of the exchange," which is defined to refer to any provision of the constitution, articles of incorporation, bylaws, or rules or instruments corresponding thereto, whatever the name, of the exchanges. Because of the long history of fixed commission rates, the Commission believes it would be appropriate, as provided by paragraph (b) of proposed Rule 19b–3, for exchanges to explicitly expunge the prior system by providing that nothing in their rules of the exchange or in their practices shall be construed to require or permit members to agree or arrange, directly or indirectly, for the charging of fixed rates of commission.

The Commission anticipates that, if proposed Rule 19b–3 is adopted, the exchanges will proceed promptly to arrange for their rules of the exchange to conform, effective May 1, 1975, if not sooner, to the requirements of Rule 19b–3 in compliance with Section 6 of the Act. Nevertheless, in the event that all necessary exchange action is not completed prior to May 1, 1975, paragraph (c) of proposed Rule 19b–3 makes clear that no member of any exchange, or person associated with a member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange which paragraph (a) of proposed Rule 19b–3 would not permit an exchange to retain after May 1, 1975.

The rules of the exchanges have complex origins that will require careful examination in light of the adoption of Rule 19b–3. The Commission believes that exchanges should promptly undertake a comprehensive review of their rules in order to be in a position, if Rule 19b–3 is adopted, to undertake educational programs to acquaint their members with the provisions of any required new or revised rules as soon as possible.

Proposed Rule 10b–22

The text of proposed Rule 10b–22 is as follows:

> *Rule 10b–22. Prohibiting Fixing Rates of Commission by Brokers, Dealers or Members of Exchanges*
>
> (a) Except as provided in paragraphs (b) and (c) of this rule, it shall be unlawful for any broker, dealer or member of any national securities exchange ("exchange"), directly or indirectly, to participate in any agreement or arrangement with another broker, dealer or member of any exchange as to the fixing of any amount to be charged to other persons in respect of transactions in securities executed on, or effected by using any facility of, such exchange.
>
> (b) Brokers, dealers and members of exchanges may participate in agreements or arrangements in respect of transactions in securities which are exempted from Rule 10b–2 by paragraph (d) thereof or are made in compliance with the provisions of Rule 10b–7 or Rule 10b–8.
>
> (c) The Commission, having due regard for the public interest and for the protection of investors, and in order to insure the maintenance of fair and honest markets, may by order exempt from section (a) of this rule any agreement or arrangement, or agreements or arrangements, in respect of transactions in securities. The Commission may act either upon written request or upon its own motion and may impose upon any exemption such terms and conditions as it deems necessary or appropriate in the public interest or for the protection of investors.

Since proposed Rule 10b–22 would be intended to prevent any circumvention of the provisions of proposed Rule 19b–3, it would not be adopted if Rule 19b–3 were not adopted. If Rule 19b–3 is adopted,

Rule 10b–22 would not, if adopted, become effective prior to May 1, 1975.

Proposed Rule 10b–22 would prohibit brokers, dealers or members of national securities exchanges from participating, directly or indirectly, in any agreement or arrangement to fix any amount to be charged to other persons in respect of exchange transactions in securities. Since the prohibition is stated in terms of fixing of any "amount" to be charged to "other persons," it would make unlawful, for example, any agreement or arrangement with respect to either public commissions (that is, commissions charged to persons who are not members of an exchange) or intramember commissions (that is, commissions charged by members to other members).[7]

If plans currently in effect under Rule 10b–2 are appropriately amended to comply with the provisions of proposed Rule 19b–3 (and such amendments are declared effective pursuant to Rule 10b–2), proposed Rule 10b–22 would not prohibit any agreement or arrangement which is exempted from Rule 10b–2 by paragraph (d) thereof and by which any brokers, dealers or members of an exchange in effect agree on or arrange for an amount to be charged to their customers. Similarly, transactions permitted by Rules 10b–7 and 10b–8 would in all cases be excluded from the prohibition of proposed Rule 10b–22.

Because the Commission's responsibilities under the Act require that, among other things, it be sensitive to

[7] In addition to other remedies available to it, the Commission could, if proposed Rule 10b–22 is adopted, censure, deny registration to, suspend for a period not exceeding twelve months or revoke the registration of, any registered broker or dealer if the Commission determined that such broker or dealer, had willfully violated the provisions of proposed Rule 10b–22 and that such censure, denial, suspension or violation was in the public interest.

factors affecting the fairness, orderliness and efficiency of exchange markets, paragraph (c) of proposed Rule 10b–22 would permit the Commission to exempt certain agreements and arrangements. The Commission would only grant an exemption if, having due regard for the public interest and for the protection of investors, it concluded that the exemption would contribute to the maintenance of fair and honest markets. The Commission would welcome views on whether any specific exclusions from paragraph (a) of proposed Rule 10b–22 in addition, or as alternatives, to those set forth in paragraph (b) should be considered.

Source Materials

Set forth below is a list of some of the more important source materials relating to commission rate matters. While the list should not be assumed to be complete or exhaustive, it may prove useful to interested persons who wish to submit views, data and arguments with respect to the proposed rules.

Exchange Act Releases:

No. 8239 (Jan. 26, 1968) NYSE proposed rate structure changes.

No. 8324 (May 28, 1968) Order for institution of hearings on Commission rates.

No. 8399 (Sept. 4, 1968) Letter to NYSE regarding interim rate structure changes.

No. 8746 (Nov. 10, 1969) Letter regarding give-ups.

No. 8791 (Dec. 31, 1969) Issues covered in commission rate hearings.

No. 9007 (Oct. 22, 1970) Request of NYSE for new rate structure proposal.

No. 9079 (Feb. 11, 1971) Announcement of unfixing rates on orders in excess of $500,000.

No. 9096 (Mar. 4, 1971) Letter to NYSE regarding fixed intra-member rates.

No. 9105 (Mar. 11, 1971) Reaffirmance of competitive rates on orders in excess of $500,000.

No. 9132 (Apr. 1, 1971) Exchange of letters on commissions on institutional size orders.

No. 9148 (Apr. 14, 1971) Reaffirmance of $500,000 breakpoint.

No. 9950 (Jan. 16, 1973) Adoption of Rule 19b–2.

No. 10383 (Sept. 11, 1973) Policy conclusions with respect to, among other things, termination of fixed commission rates.

No. 10560 (Dec. 14, 1973) Letter to NYSE regarding commission rates generally.

No. 10670 (Mar. 7, 1974) Response to $2,000 breakpoint.

No. 10986 (Aug. 27, 1974) Procedural explanation of Commission approach to unfixing of commission rates.

No. 11019 (Sept. 19, 1974) Requesting rule changes to unfix commission rates.

Special Studies:

Wharton School of Finance and Commerce, *A Study of Mutual Funds,* H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962).

Securities and Exchange Commission, *Special Study of Securities Markets,* H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

Securities and Exchange Commission, *Institutional Investor Study Report,* H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971).

Studies and Reports Prepared or Commissioned by the New York Stock Exchange:

Economic Effects of Negotiated Commission Rates on the Brokerage Industry, the Market for Corporate Securities and the Investing Public, New York Stock Exchange (Aug. 1968).

Reasonable Public Rates for Brokerage Commissions, National Economic Research Associates, Inc. (Feb. 1970).

Stock Brokerage Commissions, The Development and Application of Standards of Reasonableness for Public Rates, National Economic Research Associates, Inc. (Jul. 1970).

The Securities Markets, A Report, with Recommendations by William McChesney Martin, Jr. (1971).

Incentives to Exchange Membership in a Capital Market System, New York Stock Exchange (Nov. 1973).

Quarterly Analysis of Negotiated Rates, New York Stock Exchange (3rd qtr., 1971—2nd qtr., 1974).

Securities and Exchange Commission Hearings:

In the Matter of Commission Rate Structure of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–144 (1968–1971), consisting of 23 volumes of reported testimony and 15 volumes of written statements and exhibits.

In the Matter of the Structure, Operation and Regulation of the Securities Markets, Securities and Exchange Commission File No. 4–147 (1971), consisting of 24 volumes of reported testimony and 4 volumes of written statements and exhibits.

In the Matter of Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–167 (1973), consisting of 10 volumes of reported testimony and written statements and exhibits.

In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–171 (1974), consisting of 4 volumes of reported testimony and written statements and exhibits.

In the Matter of NASD Anti-Reciprocal Rule and Investment Company Brokerage Practices, Securities and Exchange Commission File No.

4–172 (1974), consisting of 3 volumes of reported testimony and written comments and exhibits.

In the Matter of Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–174 (1974), consisting of 4 volumes of reported testimony and written statements and exhibits.

Policy Statements:

Securities and Exchange Commission, *Report on the Public Policy Implications of Investment Company Growth,* H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966).

Securities and Exchange Commission, *Policy Statement on the Structure of a Central Market System* (Mar. 1973).

Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets* (Feb. 1972).

Congressional Hearings and Reports:

Securities Industry Study, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, S. Doc. No. 93–13, 93d Cong., 1st Sess. (1973).

Securities Industry Study, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs for the Period Ending Feb. 4, 1972, 92d Cong., 2d Sess. (1972).

Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 92d Cong., 1st and 2d Sess. (1972).

Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3126, 93d Cong., 2d Sess. (1974).

Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 470 and S. 488, 93d Cong., 1st Sess. (1973).

Hearings before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce on H.R. 5050 and H.R. 340, 93d Cong., 1st Sess. (1973).

Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3169, 92d Cong., 2d Sess. (1972).

Hearings on Securities Industry Study before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 1st Sess. (1972).

Hearings on Securities Industry Study before the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 92d Cong., 1st Sess. (1971).

Exchange Constitutions and Rules:

American Stock Exchange, Constitution and Rules, in particular, Constitution Art. VI, Rules 380–399.

Boston Stock Exchange, Constitution and Rules, in particular, Constitution Art. XVIII, Rules Ch. XVI.

Chicago Board Options Exchange, Constitution and Rules, in particular, Rules Ch. XIV.

Chicago Board of Trade, Rules and Regulations, in particular Rules Ch. VIII.

Cincinnati Stock Exchange, Rules and By-Laws, in particular, Rules Sec. 54, By-Laws Secs. 1, 2, 3, 4.

Detroit Stock Exchange, Constitution and Rules, in particular, Constitution Art. XVIII, Rules Ch. VII.

Intermountain Stock Exchange, Constitution and Rules, in particular, Rules Art. XVI.[8]

Midwest Stock Exchange, Constitution and Rules, in particular Rules Art. XXVIII.

[8] As indicated in n. 2, the Intermountain Stock Exchange will amend Art. XVI, effective May 1, 1975.

National Stock Exchange, By-Laws and Rules, in particular, Rules Art. 3–18.

New York Stock Exchange, Constitution and Rules, in particular, Constitution Art. XV, Rules 365–387.

Pacific Stock Exchange, Constitution and Rules, in particular, Constitution Art. XIII, Rule IV.

PBW Stock Exchange, Constitution and Rules, in particular, Constitution Art. XIX, Rules 671–698.

Spokane Stock Exchange, Constitution and Rules, in particular, Constitution Art. XIX.

Miscellaneous Materials:

Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public,* 22 Stan. L. Rev. 675 (1970).

Demsetz, *The Cost of Transacting,* Quarterly Journal of Economics (Feb. 1968).

Friend and Blume, *The Consequences of Competitive Commissions on the NYSE* (1972). Reprinted in *Stock Exchange Commission Rates, Hearings before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs.* Also appears, in condensed form, in 28 Journal of Finance 795 (Sept. 1973).

Kahn, *The Economics of Regulation,* Vol. II, pp. 193–209. (1971).

Lorie, *Public Policy for American Capital Markets,* submitted to the Secretary and Deputy Secretary of the Treasury (Feb. 7, 1974).

Ratner, *Regulation of the Compensation of Securities Dealers,* 55 Cornell L. Rev. 348 (Fall, 1970).

All persons who wish to appear at the oral hearings should inform George A. Fitzsimmons, Secretary of the Commission, Room 892, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, telephone number (202) 755–1160, not

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later than November 8, 1974. Persons intending to appear should file with the Secretary 30 copies of the text of any prepared statements not later than 48 hours prior to their appearance and are invited, at the time of their appearance, to make additional copies of their statements available for the benefit of the press and all other interested persons. Persons wishing to make written submissions of views, data and arguments should file 30 copies thereof with the Secretary no later than December 10, 1974. Copies of all submissions, as well as transcripts of the oral hearings, will be made available in the Public Reference Room, 1100 L Street, N.W., Washington, D.C., and at each regional office of the Commission. Persons wishing to submit written views, data or arguments in respect of submissions made by others or in respect of views, data and arguments presented at the oral hearings may do so until December 24, 1974. All submissions should refer to Securities and Exchange Commission File No. 4–176.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

Securities and Exchange Commission

Washington, D.C. 20549

SECURITIES EXCHANGE ACT OF 1934

Release No. 11093/November 8, 1974

FIXED COMMISSION RATES ON EXCHANGE TRANSACTIONS
(FILE NO. 4-176)

On October 24, 1974, the Securities and Exchange Commission released for public comment proposed Securities Exchange Act Rules 19b-3 and 10b-22.[1] The Commission also announced that it would hold oral hearings, beginning on November 19, 1974, to obtain oral presentations of views, data and arguments and published a list of source materials to which interested persons could refer in submitting comments on the proposed rules. In addition, the Commission is today releasing the following staff synopsis relating to fixed commission rates on exchange transactions.

[1] Securities Exchange Act Release No. 11073, 39 Fed. Reg. 38396 (Oct. 31, 1974). Proposed Rule 19b-3 would, among other things, prohibit national securities exchanges from adopting or retaining any rule of the exchange that requires, or from otherwise directly or indirectly requiring, members to charge any person any fixed rate of commission for transactions executed on, or effected by use of any facility of, such exchanges. Proposed Rule 10b-22 would, among other things, make it unlawful for any broker, dealer or member of any national securities exchange, directly or indirectly, to participate in any agreement or arrangement with another broker, dealer or member of any exchange with respect to the fixing of any amount to be charged to other persons in respect of transactions in securities executed on, or effected by using any facility of, such exchange.

Introduction

From the enactment of the Securities Exchange Act in 1934 until 1968, rates of commission for transactions on exchanges were adjusted at infrequent intervals; for example, the commission rates of the New York Stock Exchange (the "NYSE") had been adjusted five times, or roughly once every seven years.[2] Beginning, however, with the *Wharton Report*[3] in 1962 and the *Special Study* in 1963, the exchange commission rates became the subject of intensive study, and, since 1968, the exchanges have made numerous changes in their commission rates, often in response to requests from the Commission. Since 1958, the NYSE's commission rates and related proposals have generally been followed by other exchanges and, accordingly, the following discusssion often refers to the NYSE's proposals and the Commission's reactions to them.

Commission Action Relating to Fixed Commission Rates

In January, 1968, the NYSE, in response to Commission concern with respect to the operation of the commission rate schedules then in effect, submitted to the Commission a proposal for certain revisions in the structure of its commission rate schedule. The proposal provided for volume discounts, economic access to the NYSE for non-member broker-dealers through a professional discount, limited recognition of "customer-directed give-ups"[4] and prohibitions on

[2] Securities and Exchange Commission, *Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963) (hereinafter referred to as the *Special Study*), pt. 2 at 329–333.

[3] Wharton School of Finance and Commerce, *A Study of Mutual Funds*, H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962).

[4] The customer-directed give-up was a payment by the executing broker of a part of the minimum commission it was

procedures then used by institutions to recapture commissions. The Commission's release with respect to that proposal described in some detail the commission rate schedule then in effect.[5] The release also described in some detail the give-up and reciprocal business practices which had been adopted in order to evade the fixed commission structure.[6]

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required to charge its customer to other broker-dealers designated by the customer or his investment adviser. The amount of the payment was negotiated.

[5] Securities Exchange Act Release No. 8239 (Jan. 26, 1968). The schedule then in effect prescribed a minimum commission rate, based on the value of the 100-share round lot, for each transaction regardless of size—the commission on an order for 10,000 shares was required to be 100 times the commission on an order for 100 shares. The *Institutional Investor Study Report* of the Securities and Exchange Commission, H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971) (hereinafter referred to as the *Institutional Investor Study Report*), later accepted the conclusions of the July NERA Report prepared for the NYSE (see n. 13, *infra*) with respect to costs of executing transactions. It stated that "the average cost of handling a 1,000 share, a 10,000 share and a 100,000 share order of a $40 stock in 1969 was respectively, about 6, 42 and 377 times as great as the average cost of handling a 100 share order, yet the commission charged in 1968, was respectively, 10, 100 and 1,000 times the 100 share commission [footnote omitted]." *Institutional Investor Study Report*, vol. 4, at 2172.

[6] Normally, the customer's investment adviser directed give-ups to those brokers who had rendered it various services. The give-up was, thus, a means of utilizing the commission dollars paid by redirecting them to others in return for services often unrelated to the transaction that generated the commission. *See Special Study*, pt. 2 at 316; Securities Exchange Act Release No. 8239 (Jan. 26, 1968), 33 Fed. Reg. 2393 (Jan. 30, 1968). The *Institutional Investor Study Report* concluded in vol. 4, at 2199:

"The prevalence of the give-up demonstrated that NYSE firms specializing in execution and clearance for institutions were willing to perform this function for significantly less than

After receiving comments, the Commission instituted a public investigatory hearing to consider whether changes should be made in the rules, policies, practices and procedures of exchanges repecting commission rate structure since it appeared that the commission rate structure then in effect did not, in fact, provide fixed minimum commission charges on many exchange transactions. As an interim measure, the Commission requested adoption of a revised commission rate schedule which, among other things, prescribed reduced rates for that portion of an order involving round lots in excess of 400 shares or, alternatively, the elimination of requirements for minimum rates of commission on all orders in excess of $50,000.[7]

In the midst of the hearings the NYSE stated that it would adopt an interim commission rate schedule providing for volume discounts and that it would retain economic consultants to develop a cost-based commission rate schedule. In December, 1968, the NYSE and other exchanges adopted, as an interim commission rate schedule, a volume discount on orders over 1,000 shares and at the same time banned customer-directed give-ups, which the Commission had indicated were inconsistent with a premise that a fixed minimum commission schedule was necessary and appropriate to the effective and efficient operation of an exchange.[8]

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the commission imposed by the NYSE commission schedule and that other NYSE members not participating in the execution and clearance of portfolio orders were receiving commission dollars at the direction of the institution for services unrelated to the portfolio transactions, perhaps for example, for the sale of investment company shares."

[7] Securities Exchange Act Release No. 8324 (May 28, 1968).

[8] Securities Exchange Act Releases Nos. 8382 (Aug. 9, 1968) and 8399 (Sept. 4, 1968).

The economic study commissioned by the NYSE was scheduled to be based on data for the year 1969 and to be completed by June, 1970, and the Commission agreed to await completion of that study before resolving the basic question of whether rate-fixing by exchanges should be replaced by competition.[9]

[9] Nevertheless, certain of the issues under consideration were recognized as having been sufficiently identified and explored at the hearings to allow the Commission to invite written submissions and to hear oral presentations in preparation for the resolution of those issues, in whole or in part. Therefore, a list of questions was published in order to give specific direction to views and comments on those issues. Securities Exchange Act Release No. 8791 (Dec. 31, 1969). In response to that invitation the Antitrust Division of the Department of Justice stated that, on the basis of its review of the hearings and study of the problem, it believed that a sound and reasonable method of transition could be and should be developed:

"A transition program would permit the Commission to institute competitive commissions gradually. It would be appropriate to begin with that part of securities trading in which effective and workable competition has already been evidenced, and where fixed rates have led to serious difficulties—i.e., the larger-volume transactions. The Commission could thus order the elimination of fixed rates on all transactions over a certain size and gradually reduce the specified size until all minimum rates had been eliminated. A gradual transition would also permit firms to adjust to the competitive system and would provide the Commission with an opportunity to take regulatory measures * * * to deal with any problems which may emerge.

"Accordingly, we recommend that the Commission should proceed to formulate a program of transition to competitive commissions, and to take appropriate action to put the program into effect under the Exchange Act, including Section 19(b)."

Memorandum of the United States Department of Justice on the Fixed Minimum Commission Rate Structure, January 17, 1969, at 194–195. *In the Matter of Commission Rate Structure of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–144 (1968–1971).

The preparation of the NYSE-commissioned study was subsequently accelerated; on February 12, 1970, the NYSE announced that its Board of Governors had reviewed a proposed new rate schedule approved by its Cost and Revenues Committee and authorized its presentation to the Commission. The NYSE presented to the Commission a study entitled "Reasonable Public Rates for Brokerage Commissions—A Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange" (the "February NERA Report"). The NYSE subsequently made clear, however, that its Board of Governors had not approved the proposed commission rate schedule set forth in the February NERA Report and that the February NERA Report was merely a study presented for discussion.[10]

In March, 1970, the NYSE proposed the imposition of an emergency 90-day surcharge on orders of 1,000 shares or less, to which the Commission did not raise any objection.[11] When the NYSE proposed to continue the surcharge for an additional 90 days, the Commission held public hearings on the proposal and determined not to raise any objection if the surcharge should be continued until such time as circumstances warranted its termination.[12]

The Commission thereafter reconvened hearings to analyze a new commission rate schedule proposed in June, 1970, by the NYSE. The NYSE proposal departed from a cost-based schedule, such as that set forth in the February NERA Report, by limiting

[10] NYSE Special Membership Bulletin, Feb. 12, 1970; NYSE Special Membership Bulletin, Feb. 19, 1970.

[11] Securities Exchange Act Release No. 8860 (Apr. 2, 1970).

[12] Securities Exchange Act Releases Nos. 8923 (July 2, 1970) and 8969 (Aug. 31, 1970).

increases on small orders and decreases on large orders called for in the original study.[13]

In October, 1970, the Commission concluded that the data submitted in support of the NYSE proposal did not provide a complete answer to the problems of commission rate structure, but that it would not be in the public interest to leave the subject indefinitely in abeyance. Accordingly, the Commission stated that it would not raise any objection if the proposed schedule were adopted with specified modifications and upon the understanding that specified steps would be taken to provide a better basis for the determination of commission rates. At the same time the Commission stated that it was of the opinion that fixed charges for portions of orders in excess of $100,000 seemed neither necessary nor appropriate and it further requested that a plan for reasonable economic access for nonmember broker-dealers be presented.[14]

[13] The NYSE submitted in support of its proposal a revised study entitled "Stock Brokerage Commissions, the Development and Application of Standards of Reasonableness for Public Rates, A Report by National Economic Research Associates, Inc. to the Cost and Revenues Committee of the New York Stock Exchange" (Jul. 1970) (the "July NERA Report"). The February NERA Report had proposed a 116.3 percent increase in the commission on an order involving 100 shares of a stock selling at $10 per share. The NYSE proposal in July called for a 50 percent commission increase for that order. For an order of 1,000 shares of a stock selling at $50 per share, the February NERA Report had proposed a 36.3 percent commission rate reduction. The July NYSE proposal called for a 10 percent commission increase for that order. For further comparisons, see Table XI–4 of the February NERA Report and Tables XI–3 and XII–3 of the July NERA Report.

[14] Securities Exchange Act Release No. 9007 (Oct. 22, 1970). Nevertheless, by the end of 1970 it appeared that the banning in 1968 of customer-directed give-ups and the simultaneous in-

By March, 1971, when the Commission transmitted the *Institutional Investor Study Report* to the Congress, it had concluded:

> The fixed minimum stock exchange commission on large orders has led to the growth of complex reciprocal relationships between, on the one hand, institutions (particularly mutual fund managers and banks) and, on the other, broker-dealers. This has had the effect of making commission rates for institutions negotiable but limiting the extent to which the ultimate investor rather than the money manager has benefited from such negotiation. As noted earlier, these relationships tend to aggravate potential conflicts of interest, to be anticompetitive in nature and to impede the development of a central market system for securities trading. Elimination of fixed commission rates for institutional size transactions should go some distance toward dealing with these problems.[15]

Nothing that has occurred since the submission of the *Institutional Investor Study Report* suggests any need to withdraw its perception of the regulatory problems of the fixed commission rate structure.

In April, 1971, at the direction of the Commission, exchanges provided that commissions on the portion of exchange orders involving $500,000 or more were to be competitively determined. In July, 1971, the Commission reconvened its commission rate hearings to receive testimony and other relevant data concerning a proposed rate structure based in part on the methodology

troduction of the volume discount had not solved the regulatory problems of fixed commission rate schedules. *See*, Address by Robert W. Haack before the Economic Club of New York, Nov. 17, 1970, quoted in *The New York Times*, Nov. 18, 1970, at 76, col. 8. *See also Institutional Investor Study Report*, vol. 4, at 2206.

[15] *Institutional Investor Study Report*, vol. 1, at xxii.

developed in the preceding year by the economic consultants engaged by the NYSE. The following September, the Commission advised the NYSE that it would not raise any objection to the new rate schedule if certain additional modifications to then prevailing commission-related practices were effected (including implementation of economic access for non-member brokers at a discount of up to 40 percent from the public rate).[16]

Beginning in October, 1971, the Commission held hearings on the structure of the securities markets and, on February 2, 1972, issued its *Statement on the Future Structure of the Securities Markets* (the "*Market Structure Statement*"), which was based on those hearings as well as the earlier studies and hearings extending back over a decade.[17] The *Market Structure Statement* concluded that a reduction to $300,000 was indicated in the breakpoint above which commission rates on exchange transactions should be competitively determined. In reaching that conclusion, however, the *Market Structure Statement* noted that the securities industry had operated under fixed com-

[16] The Commission also indicated that the inability appropriately to allocate costs and revenues between brokerage and other activities engaged in by members had necessitated consideration of the proposal on the basis of the total financial experience of member firms and that it was continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. *See* Securities Exchange Act Releases Nos. 9148 (Apr. 14, 1971) and 9351 (Sept. 24, 1971).

[17] The *Market Structure Statement* expressed the unanimous view of the then Commission (Chairman Casey and Commissioners Owens, Needham, Herlong and Loomis), although Commissioner Owens took a different view with respect to restrictions on transactions by institutionally affiliated brokerage firms for their institutional affiliates.

mission rates for a very long time and that it would therefore be appropriate to measure the effect of competitively determined commissions carefully, on a step-by-step basis. The Commission recognized the possible risk of a precipitate movement towards competitive rates, but concluded that that did not rule out moving towards competitive rates, at least on large orders, at a measured, deliberate pace.[18] In response to the Commission's conclusions, the breakpoint on fixed commission rate schedules was lowered to $300,000 in April, 1972.

Congressional Conclusions With Respect to Fixed Commission Rates

At the same time that exchanges, in response to requests from the Commission, began introducing competitively determined commission rates on large transactions, the Congress was studying the operation of the securities industry and securities markets of the United States. After reviewing arguments that the abolition of minimum commissions entailed greater risks than are necessary to achieve the objectives of a

[18] *Market Structure Statement* at 16. At about the same time, the *Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce* concluded, after looking at the business practices of the brokerage industry that had arisen over the preceding several years in response to the abolition of the customer-directed give-up: "Institutions and the brokerage community were able to split commissions by devices which achieved the same results as 'give-ups,' such as the 'four-way ticket'; the 'eight-way ticket'; the 'step-out'; the 'mirror transaction,' and other similar schemes which have been aptly described as 'Byzantine.'" *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce*, H.R. Doc. No. 92-1519, 92nd Cong., 2d Sess., at 133 (1972) (hereinafter referred to as the *House Study*).

fair and economic level and structure of commission rates, an interim report issued by the Senate Subcommittee on Securities reached the same conclusions that the Commission had earlier reached. That report stated:

> While it is concededly impossible to predict the precise consequences of eliminating the fixed minimum commission rate system, it is equally impossible to predict the precise consequences of maintaining that system. There are risks in standing still as well as in moving forward. The experience of the securities industry over the past several years is hardly such as to inspire confidence in the adequacy of the present system. * * * To the extent that fixed commission rates failed to prevent, or even aggravated, these conditions, the relative "risks" of moving toward a new system are correspondingly lessened.
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> On the basis of a review of these developments and the opposing arguments as to the relative merits of fixed and competitive rates, it is clear that the interests of the investing public, as well as the long-term health of the securities industry itself, require that stock exchange members be free to set their own commissions on transactions effected for their customers, subject to whatever anti-discrimination rules or other protections the SEC may deem appropriate.
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> This does not, of course, mean that the fixing of rates should be eliminated in one step. Even the sharpest critics of the fixed rate system have recognized the need to permit the industry to adjust to rate competition in an orderly manner over a period of years. However, in order to begin making that adjustment, the industry needs, and is entitled to, a clear statement of

> government policy that fully competitive rates are the goal toward which we are moving.[19]

The Report of the Senate Committee on Banking, Housing and Urban Affairs on S. 470 subsequently stated that the issues of institutional membership and fixed commission rates, while to some extent analytically distinct, were, as a practical matter, inseparable:[20]

> [A]lthough the committee believes that fully competitive rates are necessary and appropriate for the long-term health of the securities industry, the development of a true central market system, and the protection and fair treatment of investors, there are serious difficulties with any attempt by the Congress to set the precise date on which fixed rates are to be eliminated.[21]

The Senate Committee decided, therefore, not to remove from the Commission its power to regulate

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[19] *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the Senate Committee on Banking, Housing and Urban Affairs* (For the Period Ended February 4, 1972), 92nd Cong., 2d Sess., at 57–60 (1972). *Cf.*, Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973), which provided that clear statement.

[20] The Commission was similarly persuaded that the issues were, in some respects, related but nevertheless determined that it was appropriate to take initial action on the matter of proper utilization of exchange memberships. It ultimately adopted Rule 19b–2 under the Act (Securities Exchange Act Release No. 9950 (Jan. 16, 1973), 38 Fed. Reg. 3901 (Feb. 8, 1973)) without, foreclosing the possibility that further changes might be necessary or appropriate.

[21] *Regulation of Securities Trading by Members of National Securities Exchanges and the Sale of Investment Advisers of Registered Investment Companies, A Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 470*, Sen. Doc. No. 93–187, 93d Cong., 1st Sess., at 3 (1973).

exchange practices and set the pace for evolutionary changes, subject, of course, to any judicial review as might be appropriate. It noted that:

> So long as commission rates remain fixed and institutions, and all other investors, are unable to obtain brokerage services at prices which the forces of competition have determined to be reasonable, there will inevitably be efforts to circumvent the effect of fixed rates. These efforts have resulted and undoubtedly will continue to result in the creation of complex reciprocal practices which cause inefficient allocations of economic resources, exacerbate conflicts of interest, foster anticompetitive business practices and impede the development of a central market system for securities trading.[22]

The House Subcommittee on Commerce and Finance reached the same basic conclusions:

> The fixed commission rate system has led to heightened conflicts-of-interest and distortions in trading patterns. The economic incentive for these patterns should disappear with the implementation of a competitive rate system. [Footnote omitted.] Such a system will also allow investors to purchase only those brokerage services they desire and at prices which are reasonably related to cost. [Footnote omitted.]
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> Other benefits will also accrue under a competitive system. Fixed minimum rates have tended to focus brokerage house executives' efforts on building sales, with little or no regard for costs. A competitive rate system will change this focus and will, we believe, benefit both the industry and its customers.
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> It is also clear from the record that the central market system, which appears to have the unqualified support of all segments of the securi-

[22] *Id.*

> ties industry and those who regulate it, can never be accomplished in an environment of fixed rates. * * * [T]he abolition of fixed minimum rates will facilitate the speedy development of a central market system.[23]

The House Subcommittee also recognized that there was general agreement that the securities industry had lived its whole life (insofar as exchange agency business was concerned) in a world of fixed prices and needed time to adjust to the world of competition and that a balance must be struck between the need of the industry to adjust and the rights of investors.[24]

The Commission's Policy Conclusion

In May, 1973, the NYSE proposed to increase rates by 15 percent on orders from $5,000 up to $300,000 and by 10 percent on orders involving from $100 to $5,000, and to remove the then existing prohibition, which had originated in 1970, on charging small investors more than the minimum commission. The Commission received comments on that proposal at a public hearing and, in September, 1973, determined not to raise any objection to the proposed increases or to their continuation through March 31, 1974.[25] The Commission further determined that it would not

[23] *House Study* at 141–142.

[24] *House Study* at 143.

[25] Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973). On the preceding March 1, however, the NYSE Board of Directors had adopted a resolution calling for a combined program of legislation and regulation concurrently eliminating fixed commission rates on all orders and establishing the requirement that all trades of listed securities be made on registered national securities exchanges operating under similar rules and regulations. NYSE *Policy Statement*, March 1, 1973.

On September 3, 1974, the NYSE proposed to increase rates again. As subsequently modified, the NYSE's proposal called for an increase of 8 percent on minimum rates of commission on transactions involving from $5,000 to $300,000. After re-

raise any objection if those increased rates should be continued by the exchanges from April 1, 1974, to April 30, 1975, if rules were adopted (i) eliminating prohibitions on member firms' charging, on small orders, commission rates exceeding the minimum commission and (ii) permitting, but not requiring, member firms to compete to a limited extent on the basis of the price of brokerage services. The Commission also indicated that it would act promptly to terminate the fixing of commission rates after April 30, 1975, if the exchanges did not, on their own initiative, adopt rule changes achieving that result.

Subsequently, the NYSE proposed to provide for competitively determined commission rates on transactions involving less than $2,000. That proposal, as later modified by the NYSE to exclude intra-member rates (that is, rates paid by members to other members for floor brokerage and clearance), was adopted by the NYSE and other exchanges and became effective on April 1, 1974. In withdrawing its initial proposal, the NYSE Board of Directors stated that it did not believe it was necessary to amend the intra-member rate schedules as originally proposed in order to provide experimentation with competitively determined commission rates. The Commission then held a public hearing with respect to intra-member rates. In its opening statement at the hearings, the NYSE announced its willingness to abandon fixed intra-member commission rates for clearance.[26]

ceiving information with respect to the NYSE's proposal and holding a public hearing, the Commission determined not to invoke its jurisdiction to object to the NYSE's proposal. *See* Securities Exchange Act Release No. 11089 (Nov. 6, 1974).

[26] Statement of James J. Needham, *In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–171 (1974), Transcript at 4–5.

The Commission's Request and Subsequent Rule Proposal

Following a preliminary announcement on August 27, 1974,[27] of its plan to initiate steps concerning the alteration of the existing rules and practices of national securities exchanges requiring members to charge fixed rates of commission on securities transactions effected on exchanges, the Commission on September 19, 1974, made a formal request that national securities exchanges effect necessary changes in their constitutions, rules and practices so as to eliminate those elements that required, or had the effect of requiring, exchange members to charge any person any fixed rate of commission.[28] One national securities exchange has indicated that it would comply with the Commission's request; seven national securities exchanges have indicated that they would not comply voluntarily with the Commission's request.[29]

[27] Securities Exchange Act Release No. 10986.

[28] Securities Exchange Act Release No. 11019 (Sept. 19, 1974), 39 Fed. Reg. 35214 (Sept. 30, 1974). In addition, the Commission indicated that it had not been persuaded, on the basis of the data and views obtained at the public hearings on intramember rates and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intramember rates.

[29] The Intermountain Stock Exchange has indicated that it would comply with the Commission's request. The American, Boston, Chicago Board Options, Cincinnati, Detroit, Midwest and New York Stock Exchanges have indicated that they would not comply.

The American Stock Exchange (the "Amex") has indicated that, after giving detailed consideration to the Commission's request and to the question of uniform versus negotiated commission rates, it (1) would seek a hearing to present the Amex's position on the need to retain uniform commission rates

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Accordingly, in Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 Fed. Reg. 38396 (Oct. 31,

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and (2) had determined that it could not accede voluntarily to the Commission's request. The Amex has accordingly requested an opportunity to submit to the Commission its written and oral views.

The Chicago Board Options Exchange (the "CBOE") has indicated that it will continue its policy of conforming its rate structure basically to whatever may be the rate structure from time to time elsewhere. In accordance with that policy, the CBOE would have expected to file rule changes complying with the Commission's request if the other major exchanges had done so on or before November 1, 1974; but, since the other major exchanges have not done so, the CBOE will either submit its arguments or simply await the outcome of the Commission's proceedings. The CBOE believes that, with respect to its Board Brokers (who differ from the specialists on other exchanges in that Board Brokers do not have a dealer function), the proper solution is to require that each Board Broker post his rates and that such rates be uniform and non-discriminatory among customers. The CBOE will request an exception to Rule 19b–3 if and when other floor rates are required to be negotiated.

The Cincinnati Stock Exchange (the "CSE") has stated that it is of the opinion that to adopt rules permitting fully negotiated commission rates would not be in the public interest because to do so would only favor the large institutional investor and thus place a burden on individual customers, who are said to generate the most business for the majority of the CSE member firms. The CSE is also of the opinion that negotiated commissions would not be in its member firms' interest since many smaller firms could simply not compete with larger organizations; the inability to compete does not necessarily mean an inefficiently run operation, but rather that a small business is unable to face the stiff competition of big business. The CSE is, finally, of the opinion that negotiated commission rates would not be in its interest since, with the elimination of many of its member firms and the institutionalization of the market, the CSE would cease to exist. In July, 1974, the CSE did, however, eliminate fixed intra-member rates. The CSE believes that the demise of the auction market would be a great disservice to the general investing public.

1974), the Commission published proposed Rules 19b–3 and 10b–22 and scheduled oral hearings, commencing

The Detroit Stock Exchange has reviewed the results of an advisory vote of its membership and took no action with respect to amending its constitution to eliminate the fixed commission structure.

The Midwest Stock Exchange, Incorporated (the "MSE"), has reaffirmed its position, first announced in June, 1973, favoring elimination of fixed public rates. In so doing, the MSE stated that it recognized that public policy calls for the early ending of fixed public rates. At the same time, it stated, in light of a number of unfavorable circumstances or unresolved problems, the MSE believes that there is need for caution as to the effective date of the transition and hopes that the Commission will explore the present areas of concern and prospects for alleviating them before finally settling on a May 1, 1975, effective date. The MSE observed also that its June, 1973, position that a competitive rate environment is preferable to a regulated rate environment from all viewpoints is predicated on meeting concerns that (1) exchange membership for the purpose of handling affiliated business should not be permitted; (2) nation-wide clearance and depository facilities on an interfaced basis should be in existence so as to strengthen the industry operationally; and (3) there should be appropriate restructuring of operating and regulatory methods to fit the new environment in which exchange membership will no longer be defined in terms of preferred rate treatment. The MSE also indicated that it believes there may be new problems bearing on the appropriate effective date for complete termination of fixed public rates, including (1) fiduciary principles with respect to commissions and (2) a greatly deteriorated national and world economic situation, including monetary stress, oil and food situations and extremely high rates of inflation and money costs, all of which continue, it stated, to have serious direct impacts on the securities industry. The MSE noted further that it hoped that the hearings will provide an opportunity not only to explain further its belief that those concerns and problems should be taken into account in fixing an effective date for the transition to competitive public rates, but also to explore possibilities for their early resolution. In the case of floor rates, the MSE stated its belief that there should be fur-

on November 19, 1974, as an adjunct to the rule-making proceeding.

Collateral Considerations

The foregoing background information is only a brief summary of more than a decade of Commission and Congressional study and Commission action with respect to fixed rates of commissions on exchange transactions. Not included is any review of related questions, such as the financial conditions of the brokerage industry and preservation of its ability to provide professional investment services in the context of changes in commission rate practices of long standing, the growth in institutional trading on exchange markets and the back-office crisis in the brokerage community in 1969 and 1970 and its aftermath.

Before institutional trading on exchanges had become significant, anomalies of commission rate sched-

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ther opportunity to explore not only the question of timing but also the substantive change itself, and it requested an opportunity to present its views on both questions at the oral hearings.

The NYSE has indicated it believes that competitive rates without concurrent legislative and regulatory safeguards would ultimately be destructive of the auction market and not in the public interest. The NYSE has therefore indicated it would comply with the Commission's request insofar as it relates to public commission rates, but only if a combined program of legislation and regulation is enacted consistent with the intent of the NYSE's policy statement of March 1, 1973, which, among other things, would require that all trades of listed securities be exposed to the flow of orders in an auction market prior to exposure to other markets. The NYSE has, however, declined to comply with the Commission's request insofar as it relates to floor brokerage commission rates. Since the combined program has not, in the NYSE's view, been enacted, the NYSE has also requested a hearing.

ules did not create such acute regulatory problems. Rapid changes, however, occurred during the 1960's in patterns of exchange trading, and there was an increase in phenomena associated with institutional reaction to the fixed commission rate structure.[30] As, however, the Commission was preparing to reach conclusions on some aspects of rate matters in 1970, the brokerage industry began to encounter substantial difficulties. Those difficulties were the consequence of turmoil caused in large part by very active trading and the absence of a corresponding recognition on the part of the securities industry of the need to increase trained and experienced back-office employees or to develop operating procedures adequate for the expanded volume.[31]

In the particular settings before the Commission, it had the responsibility to determine the pace at which changes in fixed commission rate schedules should be introduced, to proceed cautiously, tempering long-term solutions in light of possibly dangerous short-term consequences, and to avoid undue risks to

[30] In 1961, institutional trading accounted for 38 percent of public volume, based on value, on the NYSE; in 1971, it accounted for 68 percent. NYSE, *1974 Fact Book* 55 (1974). The NYSE has testified that the trend was continuing. *Hearings Before the Subcommittee on Financial Markets of the Senate Committee on Finance*, 93d Cong., 1st Sess., pt. 1, at 104–105 (1973).

[31] *See* Securities Exchange Act Release No. 8791 (Dec. 31, 1969), in which the Commission solicited views and comments concerning the fixing of commission rates. For a description of the financial and operational crisis that afflicted the brokerage community in the late 1960's, see *Securities Industry Study, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs*, S. Doc. No. 93–13 93d Cong., 1st Sess 28–29 (1973).

investor protection and the public interest.[32] Indeed, even under fixed minimum commission rates established by the exchanges, the brokerage industry has experienced substantial structural realignments.[33]

[32] Balancing competitive principles against other desirable ends cannot be done outside a regulated environment—the Supreme Court has specifically noted, "it is not for the courts to determine whether in particular settings price-fixing serves an honorable or worthy end." *United States* v. *National Ass'n of Real Estate Boards*, 339 U.S. 435, 489 (1950). For a definitive discussion of the Commission's authority under Section 19(b) of the Act, *see* Securities Exchange Act Release No. 9950, "Adoption of Rule 19b-2 under the Securities Exchange Act of 1934 Governing Utilization of Exchange Membership for Public Purposes" (Jan. 16, 1973), 38 Fed. Reg. 3901 (Feb. 8, 1973). *See also PBW Stock Exchange* v. *Securities and Exchange Commission*, 485 F. 2d 718 (3d Cir. 1973), *cert. denied*, 40 L. Ed. 2d 558 (1974). In discussing the Commission's action with respect to commission's rate review, including the policy conclusion of September 11, 1973, to terminate the fixing of commission rates, the Second Circuit recognized that measured withdrawal of the fixed commission rate structure could avoid the loss of investor funds. *Gordon* v. *NYSE*, 498 F. 2d 1303 (2d Cir.), *petition for cert. filed*, 43 U.S.L.W. 3148 (U.S., Sept. 19, 1974) (No. 74-304).

[33] A general trend toward fewer NYSE member organizations has been apparent for more than a decade. In 1961 there were 681 NYSE member organizations; that number has declined in each subsequent year but one and stood at 523 at the end of 1973. On the other hand, at the end of 1973, the number of offices operated by NYSE members remained above the corresponding number in 1961, as did the number of registered representatives. *See* NYSE, *1974 Fact Book*, 84 (1974). The NYSE has suggested that there has been a further decline in number of member firms (to 512) and branch offices (a decline of approximately six percent) during the first nine months of 1974. *In the Matter of Commission Rate Schedules of Registered National Securities Exchanges*, NYSE Exhibit 7, Securities and Exchange Commission File No. 4-174 (1974). At the end of the 1960's, there was a serious shift in the general trend towards fewer member organizations. Several major

Developments since 1970, such as implementation of the Securities Investor Protection Act of 1970,[34] revision of financial responsibility rules,[35] implementation of new rules with respect to custody of customer funds and securities [36] and improved surveillance procedures [37] have made it possible for the Commission to require changes in commission rate practices without unnecessary risk to investor protection or the public interest. As noted above, the Commission has required the introduction of competitively determined commission rates on both large and small transactions. The brokerage community has thus had an opportunity to develop methods of doing business in the new environment, and there has been an opportunity for the establishment of reasonable commission rates through the interaction of competitive forces.

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brokerage firms collapsed, exhausting the trust funds established by the exchanges to protect customers of member firms. Securities and Exchange Commission, *Study of Unsafe and Unsound Practices of Broker-Dealers*, H.R. Doc. No. 92-231, 92d Cong., 1st Sess. 16 (1971).

[34] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation, established by the Securities Investor Protection Act, had by the end of 1973, placed 94 firms in liquidation. Of that 94, six liquidations had been completed and in 78 others substantially all customer claims had been satisfied. Securities Investor Protection Corporation, *Third Annual Report 1973*, at 1 (1974). *See also The Wall Street Journal*, Nov. 7, 1974, at 4, col. 1.

[35] *Compare* NYSE Rule 325 as in effect until 1970 *with* such rule as in effect subsequently.

[36] Rule 15c3-3 under the Securities Exchange Act of 1934, 17 CFR 240.15c3-3.

[37] *See*, Securities Investor Protection Corporation, *Third Annual Report 1973*, at 16-17 (1974).

The Current Perception of Fixed Commission Rates under the Act

The history of fixed commission rates for exchange-executed transactions, of course, dates back to the Buttonwood Tree agreement in 1792. Fixed minimum rates have thus had a long history. This synopsis is not intended to indicate, and, indeed, there is no need to indicate, that the maintenance of a fixed rate system for exchange transactions has always been inappropriate.[38] Nevertheless, the foregoing review of the operation of the fixed minimum commission rate structure since the 1960's, particularly in light of the dramatic increase in trading by institutional investors, has demonstrated that the fixed rate structure, both in the 1960's and as subsequently modified, was unsuited to the new demands upon the exchange markets, particularly the influx of institutional orders.

This synopsis relating to fixed commission rates on exchange transactions is, of course, not the appropriate vehicle for coming to final determinations with respect to the reasons why proposed Securities Exchange Act Rules 19b–3 and 10b–22 should be adopted.[39] Nevertheless, based upon the data available at present, and subject to any further information,

[38] Indeed, in 1934, the Congress itself, in drafting the Act, recognized that fixed commission rates might be necessary or appropriate under particular circumstances and delegated to the Commission pervasive authority not only to eliminate a fixed rate system but, alternatively, to regulate a system of fixed rates on exchanges so long as it appeared to the Commission to be necessary or appropriate to do so.

[39] The hearings scheduled to commence on November 19, 1974, complemented by the prior hearings and studies discussed above and the other materials listed in Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 Fed. Reg. 38396 (Oct. 31, 1974), will assist the Commission in determining whether to adopt those rules or take some other appropriate action.

data and views which may be adduced at the hearings on proposed Rules 19b–3 and 10b–22, it should be noted that the Commission's constant review and analysis of the market structure and functioning, particularly since the 1960's, has contributed to a conclusion by both the Commission and knowledgeable committees and subcommittees of the Congress that the fixed rate system, even as modified over the last decade, has heightened conflicts of interest and distorted trading patterns, has seriously disadvantaged various classes of public investors and has tended to work against the development of a meaningful central market system for listed securities.[40]

Furthermore, there do not appear to be countervailing considerations which might relate to the public interest or the protection of investors that appear sufficiently significant to stay the Commission from the proposed implementation of its policy conclusion.[41]

[40] *See* pp. 2–23, *supra*.

[41] For example, *see* the *House Study*, which concurred "with the [then] president of the New York Stock Exchange that 'the fixed minimum commission rate * * * has itself been the greatest fragmenter of the market' [footnote omitted] and with his view that with fully negotiated rates business will be done on the basis of depth, liquidity, and continuity of the marketplace * * *.'" [footnote omitted] *House Study* at 138. *See also Hearings Before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 2519*, 93d Cong., 1st Sess. (1973), at 189, 191, 477; *Hearings Before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3126*, 93d Cong., 2d Sess., at 171–178 (1974).

Similar statements have been made by other industry representatives, although they have, on other occasions, modified or even retracted their prior pronouncements. *See, e.g., Hearings Before the House of Representatives Committee on Interstate and Foreign Commerce on H.R. 5050 and H.R. 340*, 93d Cong., 1st Sess. (1973), at 997; *Hearings Before the Subcommittee on*

It should be recognized that consideration could be given to whether or not an appropriate fixed rate structure should be constructed as part of a regulatory program of a type commonly employed by governmental entities that regulate utilities.

Such a program, if developed, would appear to have undesirable collateral consequences to the extent it entails a loss of freedom on the part of exchange member firms to exercise their independent judgment in seeking the business of, and furnishing services to, customers of their own choosing. Member firms have not shown any general inclination to support that kind of program, and it must be recognized that such a program would seem to call for elaborate new regulatory structures which might be inconsistent with current public policy views and introduce costs and economic inefficiencies which would have to be carefully balanced against the degree to which the regulatory purposes of the Act could thereby be furthered.[42]

More generally, the *House Study* concluded that, since price fixing is not the norm in a society of free competitive enterprise, "[t]hose who would maintain the fixed minimum commission system bear the burden of proving that it is in the public interest."[43] At the same time, the House Study noted:

Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3126, 93d Cong., 2d Sess., at 78 *et seq.*, 155–156, 161 and 178–180 (1974).

[42] In that connection, it should be noted that the exchanges have not made progress in developing a rational methodology which they would be willing to support and which could, in the Commission's judgment, be used to measure the reasonableness of such schedules in the future.

[43] *House Study* at 141. *See also* Securities and Exchange Commission File No. 4–171, Transcript at 45 (1974).

> It is often said that while most industries study problems to death, the securities industry studies solutions to death. During the past decade there have been four major studies of the securities industry conducted under the auspices of the SEC. Additionally, the SEC has conducted two major administrative proceedings focusing on the commission rate question and its impact on the structure of the securities industry. These matters have also received the attention of this Subcommittee and the Senate Securities Subcommittee in the current studies of the securities industry. In all, in the past decade there have been at least eight major studies dealing in whole or in part with commission rates and their effect on the industry. The time for study has ended. The time for action has arrived.[44]

Under present circumstances, therefore, it no longer appears necessary or appropriate, in furtherance of any of the purposes of the Act, to permit national securities exchanges to continue to fix the commission rates their members must charge. That conclusion is not retrospective and is, of course, not inconsistent with the fact that such a system in the past may have been justified or may have served valid regulatory purposes. In all events, justifications once adequate may cease to be so and, consequently, a regulatory agency's quasi-legislative action must be predicated on current needs and trends.[45] Similarly, continued monitoring of,

[44] *House Study* at 141. Nevertheless, since the *House Study*, the Commission has held four series of hearings in addition to those to be held in connection with proposed Rule 19b–3 and 10b–22. Securities and Exchange Commission File Nos. 4–167 (1973), 4–171 (1974), 4–172 (1974) and 4–174 (1974).

[45] Since, as noted at p. 34 and n. 46, *infra*, shifting trends can require modification of regulations which previously seemed necessary or appropriate, the regulatory agency in which the Congress has vested the responsibility for administering the

and possible structural changes in, the securities markets over the coming years conceivably could suggest that, under new circumstances and with further experience with the issues, reasonable men might tend toward different conclusions based upon the purposes and standards of the Act."[46]

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relevant statutory provisions must exercise a continuing oversight.

Current needs and trends not only are the predicate for requiring that old rules and practices be abandoned: they also require the agency to ensure that new policies are not circumvented. Thus, the Commission has proposed Rule 10b–22 to be adopted if proposed Rule 19b–3 is adopted. At the same time, implementation of a new regulatory environment, even after years of preparation and experimentation, may require some flexibility. On that basis, the administrative process should explore particular ramifications of the new policy carefully and under controlled circumstances, in terms of the relevant statutory principles. Subsection (c) of proposed Rule 10b–22 is an effort to provide an appropriate method by which the Commission can fulfill that important function.

[46] As the Commission previously has noted, in an analogous context—the adoption of Securities Exchange Act Rule 19b–2:

"The action taken * * * in adopting Rule 19b–2 is not intended to and could not, in light of shifting currents and patterns in the structure of the nation's securities markets, be a definitive resolution of the problems facing the securities industry in this area. * * *

* * * * *

"We have not, in adopting Rule 19b–2, foreclosed the possibility that further changes may, after experience with the rule is gained and after the emerging structure of a central market system is more sharply delineated, be necessary or appropriate. * * * In an area of activity as dynamic and complex as this, there may not be any permanent resolution of industry problems; as conditions change, existing problems may be superseded by new problems, and existing "solutions" may be rendered obsolete. The effective utilization of administrative responsibility and pervasive regulatory oversight de-

As previously indicated, all persons who wish to appear at the oral hearings, which commence on November 19, 1974, should inform George A. Fitzsimmons, Secretary of the Commission, Room 892, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C., 20549, telephone number (202) 755–1160. Persons intending to appear should file with the Secretary 30 copies of the text of any prepared statements not later than 48 hours prior to their appearance and are invited, at the time of their appearance, to make additional copies of their statements available for the benefit of the press and all other interested persons.

Persons wishing to make written submissions of views, data and arguments should file 30 copies thereof with the Secretary not later than December 10, 1974. Copies of all submissions, as well as transcripts of the oral hearings, will be made available in the Public Reference Room, 1100 L Street, N.W., Washington, D.C., and at each regional office of the Commission. Persons wishing to submit written views, data or arguments in respect of submissions made by others or in respect of views, data and arguments presented at the oral hearings may do so until December 24, 1974. All submissions should refer to Securities and Exchange Commission File No. 4–176.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

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mands that the agency charged with oversight of an entire industry, such as the Commission, [footnote omitted] remain alert to these changing patterns and problems. We intend to do just that."

Securities Exchange Act Release No. 9950 (Jan. 16, 1973) at pp. 2–3, 38 Fed. Reg. 3902 (Feb. 8, 1973).

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 11203/January 23, 1975

ADOPTION OF SECURITIES EXCHANGE ACT RULE 19B–3

The Securities and Exchange Commission, acting pursuant to the authority vested in it by the Securities Exchange Act of 1934,[1] and particularly Sections 2, 6, 10, 11, 19 and 23 thereof,[2] has adopted Rule 19b–3. The rule will be effective as to the rates charged by members of national securities exchanges (exchanges) on transactions for persons other than members or associated members (public rates), and for clearance charges,[3] on May 1, 1975, the date originally proposed. As to floor brokerage rates, that is, rates charged to members or associated members except for clearance, the effective date will be May 1, 1976. The rule has otherwise been adopted substantially in the form pro-

[1] 15 U.S.C. 78a *et seq.* (hereinafter cited as the Act).

[2] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

[3] In its statement of May 29, 1974, at the *Intra-Member Rate Hearings*, the New York Stock Exchange concluded that fixed rates for clearance could be determined on a competitive basis at the same time as public rates were so determined. Statement of James J. Needham, *In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–171 (1974), Transcript at 4–5.

posed.[4] The Commission has determined not to adopt proposed Rule 10b–22.

The Commission's determination to defer the effective date of the rule as to floor brokerage rates is based essentially on the following considerations. In the first place, the Commission recognizes that the transition to competitive public rates will create problems of adjustment and accommodation for the exchanges and a deferral of the change as to floor brokerage rates may facilitate the ability of the exchanges to accomplish a smooth transition to the new environment. In addition, it appears that many exchange members did not fully appreciate until September, 1974, following intra-member rate hearings, that the Commission's policy conclusions with respect to fixed commissions, which were announced on September 11, 1973, were applicable to floor brokerage rates and that, consequently, such members may not have had the benefit of the advance notice and time for planning with respect to floor brokerage rates which the September 11th notice was intended to provide. Finally, floor brokerage rates have considerably less impact on public investors than do public rates.[5]

The Commission's decision not to adopt Rule 10b–22 is based, in part, upon a consensus which developed at the *19b–3 Hearings*.[6]

[4] Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 Fed. Reg. 38396 (Oct. 31, 1974).

[5] Nothing in Rule 19b–3, however, requires exchanges to wait until May 1, 1976, to eliminate fixed floor brokerage rates, or for that matter, to wait until May 1, 1975, to eliminate fixed public rates.

[6] *In the Matter of Proposal to Adopt Rules 19b–3 and 10b–22 Concerning the Fixing of Commission Rates by National Securities Exchanges*, Securities and Exchange Commission File No. 4–176 (1974).

Rule 19b–3 essentially prohibits any exchange from adopting or retaining any rule that requires, or from otherwise requiring, its members to charge fixed rates of commission for transactions executed on or by the use of the facilities of such exchange after the applicable effective dates. Rule 19b–3 further requires each exchange after the applicable effective dates to provide in its rules that nothing therein shall be construed to require or authorize members to agree or arrange for the charging of fixed rates of commission. The rule would also relieve exchange members and their associated persons of any obligation to comply with rules prohibited by its basic provision, regardless of whether or not the exchange has amended such rules, and such rules could no longer be relied upon. This latter provision, among other things, provides for the contingency that some exchange may not have completed the necessary process of rule amendment by the applicable effective dates of the rule.

Rule 19b–3 is intended to reach all rules governing the fixing of rates of commission on exchange transactions. Thus, for example, in the case of the New York Stock Exchange (NYSE), the provisions of Article XV of the NYSE Constitution relating to floor brokerage could be retained after May 1, 1975; but such provisions may not be retained after May 1, 1976. In addition, other rules, such as NYSE Rules 391, 392 and 393, would have to be amended by exchanges to eliminate provisions intended to preserve the fixed commission rate structure in connection with distributions outside the normal pattern of exchange transactions. It should be noted that Rule 19b–3 covers any "rule of the exchange," which is defined as any provision of the constitution, articles of incorporation, bylaws, or rules or instruments corresponding thereto, whatever the name, of the exchanges.

569-956—75——8

Introduction

In view of the importance of the issue of commission rates dealt with by the rule and the extensive consideration given to the subject over the past twelve years, not only by the Commission but by Congressional Committees, the Department of Justice, the Treasury Department, exchanges, various firms and organizations in the securities industry, investors and many independent economists, jurists and other scholars, the Commission believes it is appropriate to set forth the reasons for the rule and the relevant considerations in somewhat greater detail than is its usual practice in connection with the adoption of rules or than appears to be required by the Administrative Procedure Act.[7] At the same time, the voluminous materials on this subject which have been developed and considered since 1963 and the numerous questions with respect thereto which have received the Commission's attention make it impossible, if we are to keep this release within any reasonable compass, to do more than highlight those aspects of the matter which the Commission finds particularly significant. It is therefore impractical to undertake a detailed analysis of the large body of underlying facts which entered into the Commission's determination to adopt the rule.[8]

[7] Section 4(c) of the Administrative Procedure Act (5 U.S.C. 553(c)) provides that rules which are adopted shall incorporate "a concise general statement of their basis and purpose." It is our practice to include such a statement in the release announcing the adoption of a rule. This provision may be contrasted with Section 8(c) of that Act (5 U.S.C. 557(c)), which requires, in the case of adjudication, that the decision include a statement of "findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record."

[8] Securities Exchange Act Release No. 11073 of October 24, 1974, in which the Commission released the proposed rule for

More particularly, although the Securities Industry Association raised a question at the *19b–3 Hearings* with respect to the legal authority of the Commission to adopt any rule precluding the exchanges from having rules fixing rates of commission, and similar questions have been raised by others in the past, the Commission does not regard it as appropriate to set forth in this release the legal arguments in support of its authority to adopt the rule. In view of the broad regulatory and rulemaking authority over the securities markets and the securities exchanges, including the specific subject of commission rates, granted to the Commission by the Act, the Commission, after careful consideration of the legal issues, is satisfied that it has authority to adopt Rule 19b–3, if it makes, as it has done, the basic findings called for by the Act.

The Act was passed against the background of the stock market crash of 1929 and in the light of the extensive study and investigation by the Senate Committee on Banking and Commerce entitled "Stock Market Practices." It was consequently a basic, if not the basic, purpose of this legislation to provide for regulation of the stock market and of transactions and practices relating thereto. It was intended that this regulation be comprehensive and complete. Indeed, the Congress so stated in the preamble of the Act which stated that it is "necessary to provide for regulation and control . . . and to impose requirements necessary to make such regulation and control reasonably complete and effective." This objective was approached in a variety of ways. The Commission was established to administer the Act; and exchanges are

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public comment, contained a list of some of the more important source materials relating to this subject, which mere list covered two and one-half printed pages. Reference thereto is hereby made.

required to register with the Commission, are charged with the duty of self-regulation of their members and may become registered only if the Commission concludes, among other things, "that the rules of the exchange are just and adequate to insure fair dealing and to protect investors." In addition to statutory provisions regulating various trading practices and activities of members, Section 19(b) of the Act supplements the initial authority of the Commission over exchange rules by authorizing it to alter or supplement the rules of an exchange with respect to various significant matters, including "the fixing of reasonable rates of commission, interest, listing and other charges." The standard for such action is that such alterations be "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange." As the House Committee put it, this authority was intended to permit the Commission to effect changes in exchange rules "in any important matter . . . appropriate for the protection of investors or appropriate to insure fair dealing."[9]

In view of the complexity of the subject and of changing conditions, great reliance was placed upon broad rulemaking power so as to enable the Commission to respond flexibly to changing regulatory needs. In light of these considerations, the Commission believes that the express authority granted to it over the subject of commissions which, as the *Special Study*[10]

[9] *Report of House Committee on Interstate and Foreign Commerce on H.R. 9323*, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 15 (1934).

[10] Securities and Exchange Commission, *Report of Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

said, are "the lifeblood of the brokerage business today even as in 1972," [11] encompasses the authority to accomplish necessary changes in those rules.

An extensive discussion of the history and interpretation of the Commission's rulemaking authority under the Act is found in Securities Exchange Act Release No. 9950 (Jan. 16, 1973), 38 Fed. Reg. 3902 (Feb. 8, 1973), to which reference is hereby made.

The remainder of this release consists of the following sections:

1. Summary of the Evolution of Exchange Commission Rates and of the Commission's Consideration of Them.
2. Reasons for the Rule.
3. Comments on the Rule.
4. Conclusion.
5. Text of the Rule.

1. Summary of the evolution of exchange commission rates and of the Commission's consideration of them

The practice of fixing commission rates on stock exchanges in the United States is generally traced back to the so-called Buttonwood Tree Agreement of 1792, which provided:

> We, the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day for any person whatsoever, any kind of Public Stock at a less rate than one-quarter percent Commission on the Specie value, and that we will give a preference to each other in our Negotiations. In Testimony whereof we have set our hands this 17th day of May, at New York, 1792.[12]

[11] 2 *Special Study* 295.

[12] Eames, *The New York Stock Exchange* 14 (1894).

Although present exchange commission rate rules have become far more complex than this simple paragraph, the essentials are the same. The members undertake not to deal at a rate less than the fixed commission, that is, the public rate, and to give preference to each other, that is, the intra-member rates. The ancient lineage of exchange rate fixing, and the fact that it has persisted for over a century and a half without serious challenge, naturally provoke inquiry as to why it should be questioned now. The answer is that exchange commission rate fixing operates now in a far different environment than it did in earlier periods. During the period from 1792 to approximately the end of World War I, exchange commission rates were of little public importance. The general public was not involved to any significant extent in exchange trading in equity securities and there was some justification for regarding the stock exchanges as, in considerable measure, private clubs. While certain aspects of exchange operations gave rise to increasing public concern in the late years of the 19th Century and the opening years of the 20th Century, commission rates were not among them.

After the end of World War I, the public participated increasingly in exchange trading in equity securities and the stock market assumed unprecedented importance in the functioning of the economy. The disastrous events of 1929 demonstrated that the exchanges had not satisfactorily adapted to their new status as institutions with far reaching public reponsibilities and led to the comprehensive Congressional investigations of the early 1930's. The evils and malpractices thus uncovered, in turn, gave rise to the movement for reform which culminated in the enactment of the Act in 1934 with its comprehensive scheme of governmental regulation. But attention was then

focused primarily upon such obvious evils as corners, pools, manipulations, insider trading, and other fraudulent and deceptive practices which seriously injured investors. With respect to commission rates, there was some concern with the possible overcharging of unsophisticated investors, and with posible monopoly profits, and the Commission was given regulatory authority.

Between World War II and the early 1970's, the public flocked into the securities markets, and financial institutions increasingly participated in those markets. As a result of Congressional concern as to the adequacy of investor protection under these circumstances, two major studies were made under the auspices of the Commission. The first of these was the monumental *Special Study*, made essentially during the period from the end of 1961 to the middle of 1963, pursuant to Congressional direction embodied in an amendment to the Act. The second of these studies was the *Institutional Investor Study*,[13] made essentially in 1969 and 1970, pursuant to another amendment to the Act. The *Special Study* noted that during the 1952–1961 decade, the number of individual shareholders in America grew almost three times but that, despite this expansion, activity of individuals as a proportion of total NYSE share volume decreased from 57% in 1952 to 51.4% in 1961; during the same period, the *Special Study* observed, institutional activity rose from 24.6% in 1952 and 19% in 1953 to 26.2% of such volume in 1961.[14] The *Institutional Investor Study* noted a further decrease in the volume accounted for by the public to 33.4% at the end of 1969 and an increase in the institutional share during

[13] Securities and Exchange Commission, *Institutional Investor Study Report*, H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971).

[14] 2 *Special Study* 6.

the same period to 42.4%.[15] The institutional share has continued to rise at least through 1971, the latest year for which the NYSE has made available a public transaction study.[16]

The *Special Study* included probably the first reasonably comprehensive analysis of the nature and structure of commission rates and their impact, together with the procedures and standards involved in setting and reviewing such rates. The *Special Study* did not, however, consider the question of fixed vs. competitive commissions. Nor did it believe that it was either "called upon or equipped" to study the level of commission rates or to express any view with respect to their reasonableness. Nevertheless, the *Special Study* did point out certain problems presented by the commission rate structure, some of which are still unresolved. These include the fact that the commission rate schedule covers a great variety of services performed by brokers in addition to the execution and clearance of transactions. That characteristic of the rate schedule has induced service competition rather than price competition and has resulted in complex and irrational distinctions between permissible ancillary services and prohibited rebates of the minimum commission. The *Special Study* also noted the prevalence of reciprocal arrangements and pointed out that the nature of the securities commission business is such that traditional principles of rate regulation can hardly be applied to it. In that connection, the *Special Study* said:

> It is important to reemphasize that, while the security commission business shares, with other businesses subject to rate regulation, the qualities of being "affected with the public interest"

[15] *Institutional Investor Study*, Supp. Vol. 1 at 147.

[16] *NYSE 1974 Fact Book* 55.

and of being limited to a standard of "reasonable" rates, the differences are perhaps more significant than the similarities, and the problem here is in many ways unique. Thus, the public utility normally possesses a franchise conferring upon it monopoly rights to furnish a service required by the public and also obligating it to furnish service to all who need it at reasonable prices. In contrast, though the auction market of the NYSE is a dominant unit in the structure of our capital markets, about 500 member firms compete with each other for the business of the public to be transacted on the NYSE within the confines of the same commission rate schedule. Moreover, they compete with other investment media for the public's savings, and the Exchange itself competes as a marketplace with other markets, both for the listing of issues to be traded and for transactions in listed issues also traded on other exchanges (dually traded securities) or in the over-the-counter market.

There are other important economic differences. Public utilities generally are characterized by relatively high investment in fixed plant and equipment, while the security commission business is essentially a service business requiring relatively small capital investment but relatively high personnel costs. The income of utilities tends to be more stable than that of industry generally while that of the security commission business fluctuates much more widely. These differences make it clear that the problem of "reasonable" rate level can be solved by no simple transfer of principles evolved in the field of utility regulation to the security commission business.[17]

It was further pointed out that a basic dilemma was involved in the setting of commission rates. Tradition-

[17] 2 *Special Study* 328–329 (footnote omitted).

ally, the rates have been set, at least in part, in terms of a commission per share. This means that with a per share commission the commission charge on a given number of shares of a low priced stock is a far larger proportion of the amount invested than the commission on the same number of shares of a high priced stock. On the other hand, a commission schedule based on the dollar amount of the investment would produce a far higher commission on a given number of shares of a high priced stock than on a given number of shares of a low priced stock although the cost of executing the two orders would normally not be very different. In the context of a fixed rate structure, no satisfactory solution to this dilemma has yet been found.

The *Special Study* also pointed out that five commission rate increases occurred between the enactment of the Act and 1963, and that in connection with each, reference was made to generalized concepts of cost and profit but that the available data for the determination of these was entirely inadequate and that complex problems of allocation of costs existed as well as the even more difficult conceptual problem of giving content to the general standard of reasonableness in an industry to which traditional ratemaking concepts were largely inapplicable.

Over the years since the *Special Study*, strenuous efforts were made by the Commission and the exchanges to deal with the problems and to correct the defects pointed out. Thus, volume discounts were introduced, customer directed give-ups were abolished, income and expense data for member firms were substantially improved and efforts were made to develop principles for the allocation of costs and also to develop a ratemaking philosophy. It is fair to state, however, that the latter efforts have not been success-

ful. The NYSE has acknowledged that it has not established a basis for allocating costs between the stock exchange commission business and other business done by member firms and has requested the Commission to pass upon recent proposals for rate increases upon the basis of the overall profitability of the securities industry and the impact of inflation upon various costs incurred by member firms. The exchanges and representatives of the brokerage industry acknowledged at the *19b–3 Hearings* that they had not yet endeavored to develop and present a philosophy or a set of principles to be applied in ratemaking.

The Commission has held two major hearings with respect to rate structure since the *Special Study*. The first of these was the *Rate Structure Hearings*[18] commenced in early 1968. In those hearings, the question was, for the first time, directly raised as to whether rate fixing by exchanges should be replaced by competition. The Antitrust Division of the Department of Justice participated in those hearings in order to "raise questions concerning the relationship between * * * the Exchange Act and the public policy embraced in the Federal antitrust laws."[19] In the

[18] *In the Matter of the Commission Rate Structure of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–144 (1968–1971).

[19] It is rather surprising that, although the exchanges have been engaged in a combination to fix commission prices both before and ever since the Sherman Act was passed in 1890, the first direct antitrust challenge to stock exchange rate fixing in the federal courts did not come until the *Kaplan* case in 1966. *Kaplan* v. *Lehman Bros.*, 371 F. 2d 409 (7th Cir.), *cert. denied*, 389 U.S. 954 (1967). Perhaps this was, at first, attributable to the early idea that the commerce clause of the Constitution and the Sherman Act applied only to transactions in "commodities." *See Hopkins* v. *United States*, 171 U.S. 578, 597–98 (1898);

course of the hearings, the NYSE stated that it would retain economic consultants to develop a cost-based commission rate schedule. The Commission agreed to await completion of that study before resolving the basic question but, nevertheless, invited written submissions and oral presentations in preparation for the resolution of those issues. In response to the Commission's invitation, the Antitrust Division of the Department of Justice stated, in effect, that the Commission should develop a transitional program which would permit it to institute competitive commissions gradually, commencing with larger volume transactions.[20]

The NYSE study was thereafter accelerated and in February, 1970, the NYSE presented to the Commission a study entitled "Reasonable Public Rates for Brokerage Commissions—A Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange."[21] The NYSE subsequently made clear, however, that its Board of Governors had not approved the proposed commission rate schedule set forth in the *February*

United States v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944); *Atlantic Cleaners & Dyers* v. *United States*, 286 U.S. 427 (1932). Since 1934, federal regulation under the Act has affected the application of the antitrust laws to stock exchange actions. *See Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963). The status of stock exchange rules fixing commissions under the antitrust laws in view of the provisions of the Act is expected to be clarified by the Supreme Court in the near future unless mooted by enactment of legislation now pending in the 94th Congress. *See Gordon* v. *New York Stock Exchange*, 498 F. 2d 1303 (2d Cir.), *cert. granted*, 95 Sup. Ct. 491 (1974).

[20] *Rate Structure Hearings*. Memorandum of the Department of Justice on the Fixed Minimum Commission Rate Structure, Jan. 17, 1969, at 194–195.

[21] Hereinafter cited as the *February NERA Report*.

NERA Report and that the *February NERA Report* was merely a study presented for discussion.[22]

The Commission reconvened hearings to analyze a new commission rate schedule proposed in June, 1970, by the NYSE. The NYSE proposal departed from a cost-based schedule, such as that set forth in the *February NERA Report*, by limiting increases on small orders and decreases on large orders called for in the original study.[23]

In October, 1970, the Commission concluded that the data submitted in support of the NYSE proposal did not provide a complete answer to the problems of commission rate structure, but that it would not be in the public interest to leave the subject indefinitely in abeyance. Accordingly, while the Commission stated that it would not raise any objection if the proposed schedule were adopted with specified modifications and upon the understanding that specified steps would be taken to provide a better basis for the determination of commission rates, it also stated that it was of the

[22] NYSE Special Membership Bulletin, Feb. 12, 1970; NYSE Special Membership Bulletin, Feb. 19, 1970.

[23] The NYSE submitted in support of its proposal a revised study entitled "Stock Brokerage Commissions, the Development and Application of Standards of Reasonableness for Public Rates, a Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange" (July 1970) (hereinafter cited as the *July NERA Report*). The *February NERA Report* had proposed a 116.3 percent increase in the commission on an order involving 100 shares of stock selling at $10 per share; the NYSE proposal called for a 50 percent commission rate increase. For an order of 1,000 shares of a stock selling at $50 per share, the *February NERA Report* had proposed a 36.3 percent commission rate reduction; the NYSE proposal called for a 10 percent commission increase. For further comparisons, see Table XI–4 of the *February NERA Report* and Table XII–3 of the *July NERA Report*.

opinion that fixed charges for portions of orders in excess of $100,000 were neither necessary nor appropriate. It further requested that a plan for reasonable economic access for non-member broker-dealers be presented.[24]

In March, 1971, the *Institutional Investor Study* was transmitted to the Congress. That *Study* was basically an economic study conducted primarily by economists and it included an examination of the impact of institutional investment upon the securities markets. This aspect of the *Institutional Investor Study* is relevant to the question of commission rates since one of the principal problems with the commission rates was the generally unsuccessful effort to

[24] Securities Exchange Act Release No. 9007 (Oct. 22, 1970). In the course of the *19b–3 Hearings*, reference was made to that release as making the continuation of minimum commissions dependent on the adoption of a uniform system of accounts. While indicating that implementation of a uniform system of accounts, as well as uniform and adequate methods of cost allocation, was necessary to the continuance of a system of fixed rates for exchange transactions, that release also stated that fixed charges for portions of orders in excess of $100,000 were neither necessary nor appropriate. The inadequacies of the data submitted in support of the NYSE proposal were subsequently pointed out to the NYSE. *See* letter dated April 23, 1971, from Irving M. Pollack, Director, Division of Trading and Markets, to William C. Freund, NYSE Vice President and Economist. As indicated *supra*, p. 11, exchanges have not established a basis for allocating costs between stock exchange commissions and other business done by member firms. Furthermore, by the end of 1970 it appeared that the banning in 1968 of customer directed give-ups and the simultaneous introduction of the volume discount had not solved the regulatory problems of fixed commission rate schedules. *See* Address by Robert W. Haack before the Economic Club of New York, Nov. 17, 1970, quoted in *The New York Times*, Nov. 18, 1970, at 76, col. 8. *See also* 4 *Institutional Investor Study Report* 2206.

adapt them to the needs of both individual investors and large institutional investors. Upon the basis of the data and analysis of the *Institutional Investor Study* with respect to this matter, the Commission concluded, as stated in its letter of March 10, 1971, to the Congress in transmitting the *Study:*

> It is clear that the securities markets are changing in rapid and significant ways. There are a number of reasons for these changes; among the most important are the greatly increased volume of trading by institutions, the negotiated nature of many institutional transactions, the fixed minimum commission rates that stock exchanges impose on such transactions and technological advances in communications and data processing. The evolution of the securities markets has been, and may continue to be, affected and distorted by barriers to competition. Among the most significant of these are minimum commission rates and rules that insulate markets, market makers and broker-dealers from each other. The combination of fixed minimum commission rates and barriers to access have tended to cause institutions to choose market places, in part at least, for the purpose of reducing the commission they pay or taking advantage of opportunities to purchase various services with "soft" commission dollars by means of reciprocal practices. These appear to be the most important explanations for the accelerating growth of institutional trading on the regional stock exchanges and in the third market. Because the assembly of many block trades takes place primarily over the upstairs communications systems of broker-dealers rather than on the floor of any stock exchange, such transactions can be executed wherever the participants select, and markets have therefore been selected on the basis of these considerations.

> The fixed minimum stock exchange commission on large orders had led to the growth of complex reciprocal relationships between, on the one hand, institutions (particularly mutual fund managers and banks) and, on the other, broker-dealers. This has had the effect of making commission rates for institutions negotiable but limiting the extent to which the ultimate investor rather than the money manager has benefited from such negotiation. As noted earlier, these relationships tend to aggravate potential conflicts of interests, to be anticompetitive in nature and to impede the development of a central market system for securities trading. Elimination of fixed commission rates for institutional size transactions should go some distance toward dealing with these problems. The Commission will closely observe the extent to which competitive commission rates lead toward these results.[25]

In April, 1971, at the direction of the Commission, exchanges provided that commissions on the portion of exchange orders involving $500,000 or more were to be competitively determined. In July, 1971, the Commission reconvened its commission rate hearings to receive testimony and other relevant data concerning a proposed rate structure based in part on the methodology developed in the preceding year by the economic consultants engaged by the NYSE. The following September, the Commission advised the NYSE that it would not raise any objection to the new rate schedule if certain additional modifications to then prevailing commission-related practices were effected (including implementation of economic access for nonmember brokers permitting discounts of up to 40 percent from the public rate).[26]

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[25] *Institutional Investor Study*, Summary Vol. xxii. *See infra* n. 13.

[26] Securities Exchange Act Release No. 9351 (Sept. 24, 1971).

In not objecting to the NYSE's rate proposal the prior October, the Commission had specifically requested the presentation not alter than May 31, 1971, of a uniform accounting system in order to evaluate the need for a fixed commission rate system.[27] In September, 1971, the Commission recognized that the inability of the NYSE appropriately to allocate costs and revenues between brokerage and other activities engaged in by members had necessitated consideration of the proposal on the basis of the total financial experience of member firms. The Commission, therefore, extended until May 1, 1972, the period for submission of uniform reporting by member firms in order to permit evaluation of subsequent commission rate proposals.[28]

Beginning in October, 1971, the Commission held the *Hearings on Market Structure*[29] and, on February 2, 1972, issued the *Market Structure Statement*,[30] which was based on those hearings as well as the earlier studies and hearings extending back over a decade.[31] The *Market Structure Statement* concluded

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[27] *See* n. 24 *supra*.

[28] The Commission also indicated that it was continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. *See* Securities Exchange Act Release No. 9148 (Apr. 14, 1971).

[29] *In the Matter of the Structure, Operation and Regulation of the Securities Markets*, Securities and Exchange Commission File No. 4–147 (1972).

[30] Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets*, 37 Fed. Reg. 5286 (Mar. 14, 1972).

[31] The *Market Structure Statement* expressed the unanimous view of the Commission as it was then constituted (Chairman Casey and Commissioners Owens, Needham, Herlong and

that a reduction to $300,000 was called for in the breakpoint above which commission rates on exchange transactions should be competitively determined. In reaching that conclusion, however, the *Market Structure Statement* noted that the securities industry had operated under fixed commission rates for a very long time and that it would, therefore, be appropriate to measure the effect of competitive commissions carefully, on a step-by-step basis. The Commission recognized the possible risk of a precipitate movement toward moving toward competitive rates, but concluded that that did not rule out moving toward competitive rates, at least on large orders, at a measured, deliberate pace and that the Commission rate structure would ultimately be based upon the cost characteristics of the service being offered.[32] In response to the Commission's conclusions, the breakpoint on fixed commission rate schedules was lowered to $300,000 in April, 1972.

In May, 1973, the NYSE proposed to increase commission rates; the Commission received comments on that proposal at a public hearing and, in September, 1973, determined not to raise any objection to the proposed increases or to their continuation through March 31, 1974.[33] The Commission also indicated that

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Loomis), although Commissioner Owens took a different view with respect to restrictions on transactions by institutionally affiliated brokerage firms for their institutional affiliates.

[32] *Market Structure Statement* 16. The emphasis of the *Market Structure Statement* was on fostering free and open competition, not only with respect to commission rates but also competing market makers.

[33] On September 3, 1974, the NYSE proposed to increase rates again. As subsequently modified, the NYSE's proposal called for an increase of 8 percent on minimum rates of commission on transactions involving from $5,000 to $300,000. After receiving information with respect to the NYSE's

it would act promptly to terminate the fixing of commission rates after April 30, 1975, if the exchanges did not, on their own initiative, adopt rule changes achieving that result.[34]

Subsequently, the NYSE proposed to provide for competitively determined commission rates on transactions involving less than $2,000. That proposal, as resubmitted in amended form by the NYSE to exclude intra-member rates (that is, rates paid by members to other members for floor brokerage and clearance), was adopted by the NYSE and other exchanges and became effective on April 1, 1974. In withdrawing its initial proposal, NYSE Board of Directors stated that it did not believe it was necessary to amend the intra-member rate schedules as originally proposed in order to provide experimentation with competitive commission rates.[35] The Commission then held the *Intra-Member Rate Hearings*, at which the NYSE announced its willingness to abandon fixed intra-member commission rates for clearance.[36]

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proposal and holding a public hearing, the Commission determined not to invoke its jurisdiction to object to the NYSE's proposal. *See* Securities Exchange Act Release No. 11089 (Nov. 6, 1974), 39 Fed. Reg. 43250 (Dec. 11, 1974).

[34] Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973). The NYSE Board of Directors had already adopted on the preceding March 1 a resolution calling for a combined program of legislation and regulation concurrently eliminating fixed commission rates on all orders and establishing the requirement that all trades of listed securities be made on national securities exchanges operating under similar rules and regulations.

[35] Securities Exchange Act Release No. 10669 (Mar. 6, 1974).

[36] In Securities Exchange Act Release No. 11019 (Sept. 18, 1974), 39 Fed. Reg. 35214 (Sept. 30, 1974), the Commission indicated that it had not been persuaded, on the basis of the data and views obtained at the public hearings on intra-member rates and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intra-member rates.

During the same period the Committees of the Congress having jurisdiction over securities regulation had also turned their attention to the issue of fixed vs. competitive rates. Both the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs and the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives initiated in 1971 a comprehensive examination of the securities industry. These studies were primarily occasioned by the operational and financial crisis in the securities industry in 1969 and 1970 which had led the Congress to enact the Securities Investor Protection Act of 1970.[37] That Act, in effect, provided government insurance for investors against loss resulting from the insolvency of broker-dealers and created a potential liability of the Treasury to cover such claims. The Committees felt that they should independently study the industry to examine the conditions which made such legislation necessary. Both Committees carefully studied the problems arising from fixed commissions. The recommendations of the Senate Subcommittee contained in its Report of February 4, 1972, with respect to commission rates were as follows:

> The related questions of stock exchange commission rates and exchange membership for institutions have been the subject of intensive hearings before the SEC for 3½ years. A review of the record of these proceedings and of the statements submitted to the Subcommittee itself on these questions reveals clearly that the

[37] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation established by that Act is required to provide for the satisfaction of claims against a bankrupt broker, not exceeding $50,000 for each customer (subject to a limitation of $20,000 for claims for cash).

present distortions and fragmentation of our securities markets cannot be effectively dealt with so long as the NYSE and other stock exchanges are permitted to fix the commissions that their members must charge, at least on large transactions. The industry expects, and is entitled to, a clear statement of government policy as to when and how the present restrictions will be removed. This requires the setting of a date certain for elimination of fixed rates on institutional-size transactions, which have resulted in the most serious distortions. This could best be achieved by eliminating fixed rates on orders in excess of $100,000. In addition, to provide the possibility of lower rates to small investors, brokerage firms, after appropriate filings with the SEC, should be permitted to charge lower fees for "unbundled" services than are required by the current fixed rate schedules for the full range of brokerage services.[38]

The House Committee in its recommendations went somewhat further, stating that:

> The Subcommittee finds that fixed minimum commission rates are not in the public interest. We have reviewed our own record, the relevant portions of the SEC's record and that of the Senate study. On the basis of that review the Subcommittee finds that the fixed minimum commission rate system should be replaced by one where commission rates are determined by the forces of competition. We find further that competitively determined rates should apply to all transactions regardless of size, and that a competitive commission rate system should be phased in without excessive delay.

[38] *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the Senate Committee on Banking, Housing and Urban Affairs (For the Period Ended Feb. 4, 1972)*, 92d Cong., 2d Sess. (1972).

The SEC has indicated that it will seek reduction of the level from $300,000 to $200,000 by April of 1973 and then to $100,000 by April of 1974. The New York Stock Exchange has proposed a slightly different timetable, and stated that it will review the level for competitively determined commission rates in October 1972.

The Subcommittee has heard testimony that the difference in impact on the industry between a $500,000 breakpoint and a $300,000 breakpoint is minimal, and a number of witnesses indicated that a further reduction in the breakpoint may be warranted prior to the date scheduled by the SEC. The Subcommittee agrees. A further reduction in the breakpoint by the Exchange when it conducts its review in October is warranted. The SEC could then adjust its timetable accordingly. So long as reasonable progress along this road is being made, the Subcommittee will defer legislative action.

The Subcommittee agrees with the testimony of a large number of witnesses that there is no reason to freeze competitive rates at the $100,000 level. The Subcommittee finds no logical justification for competition on institutional size transactions while perpetuating rate fixing on transactions of small investors. If steps are not taken to continue to reduce the breakpoint below the $100,000 level until all fixed rates are abolished, the Subcommittee will introduce legislation to do so.

There has been much debate over the desirability of a fixed minimum commission rate system. But the Congress, the Department of Justice, and the SEC have determined that the public interest will best be served by replacing fixed prices with a competitive rate system. The debate should now end. If the securities industry expends as much energy in adjusting to a competitive system as it has in debating its

> wisdom, the Subcommittee is convinced that the industry will not only survive, but it will flourish.[39]

Following the completion of these *Studies,* legislation to implement the recommendations of the respective Committees was introduced in the Senate and in the House. The Senate bill passed the Senate but the House bill, although favorably reported by the Committee on Interstate and Foreign Commerce, was not acted upon in the 93d Congress. Similar legislation has been introduced in both Houses in the 94th Congress.[40]

2. Reasons for the rule

The basic reason for the Commission's decision to adopt Rule 19b–3 was the conclusion that, under present circumstances, the free play of competition can provide a level and structure of commission rates which will better serve the interests of the investing public, the securities markets, the securities industry, the national economy and the public interest than any system of price fixing which can reasonably be devised. Furthermore, the Commission concludes that there is no economic requirement for fixed rates of commission in the securities industry, as is evident from the practical experience of the over-the-counter market, where no such structure exists, as well as all of the data which has been accumulated concerning the nature and characteristics of the securities commission business.[41] Consequently, even if it were possible to

[39] *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce,* H.R. Doc. No. 92–1519, 92d Cong., 2d Sess. (1972).

[40] H.R. 10 and S. 249, 94th Cong. 1st Sess. (1975).

[41] The securities commission business, of course, is not a natural monopoly or utility which requires fixed rates because price

devise a better scheme of fixed rates, the commitment of resources would not appear to be justified under present and foreseeable conditions in view of the strong probability that no such system would work as well as competition. The foregoing conclusions are consistent with the American tradition of reliance upon free competition to determine prices and allocate resources, as reflected by the public policy embodied in the antitrust laws. It should be emphasized, however, that the Commission's conclusions are not based upon any simplistic notion that competition is a "good thing" in all lines of endeavor, including a regulated industry, and that, therefore, competitive rates should be substituted regardless of experience and circumstances. Rather, this conclusion is based upon the entire experience of the Commission and the securities industry with fixed rates, particularly during the last decade and more, and the intensive studies which have been made of that subject by so many competent persons.

The existing commission rate structure has demonstrably worked badly during that period. It has led to distortions, evasions, conflicts of interest,[42] and

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competition is impossible. It is, however, contended that the securities commission business is of so vulnerable a nature that it cannot survive price competition or, stated otherwise, that it is subject to "destructive competition." Certain reasons for rejecting that conclusion are discussed under the next heading in this release.

[42] The fixed rate structure tends to create conflicts of interest on the part of institutional investors who are usually engaged in managing investments on behalf of others, rather than investing their own money. In these cases, the institutional manager allocates the commission business among brokers but the beneficiaries, in effect, pay the commissions. Since brokers provide a great variety of services which are compensated by commissions, institutional managers are constantly tempted to direct

inefficiencies, and has obstructed at every step the ability of the securities markets to adapt themselves to the demands of our time. It has impeded the evolution of a central market system and has fragmented the markets, impairing their ability to concentrate the flow of orders and to mobilize marketmaking resources necessary to provide depth and liquidity in a market increasingly affected by institutional participation.

It has also, by its rigidity and delay, inhibited innovations in the rendering of brokerage services to the investing public and in the ability of the securities industry to adjust rapidly to the rapid fluctuations in the volume of trading and, therefore, in the demand for brokerage services. Some of these difficulties seem to be inherent in a fixed rate system as applied to a dynamic and rapidly changing industry.

When the Commission commenced its inquiry into the commission rate structures at the time of the

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the brokerage business of their beneficiaries to brokers who will provide services for the benefit of the manager. The problem is aggravated by the fact that under prevailing accounting practices and tax law, commissions are treated as part of the purchase price of securities bought, or as a deduction from the proceeds of securities sold, rather than being accounted for as expenses incurred in the management of the portfolio. Under these circumstances, investment managers may be inclined to seek services in exchange for brokerage since the cost of such services may be buried in the carrying value of the portfolio securities rather than charged to the beneficiaries as an expense of administration. The tendency of this situation to corrupt fiduciary relationships is not the least of the evils resulting from the present commission rate system. Even where no misconduct is present, the situation leads to inefficiency in the management of assets. The foregoing does not mean that fiduciaries may not utilize commissions on transactions for beneficiaries to obtain for their beneficiaries research and other valuable services. Certain aspects of this matter are discussed below in connection with the so-called "fiduciary question" raised by certain persons in connection with the proposed rule.

Special Study, fixed commission rates were assumed by everyone, including the Commission, to be a normal and necessary feature of the exchange markets. It became more and more clear in the light of later experience that this was not the case. However, the virtues of the traditional system were staunchly defended throughout the Commission's hearings in 1968 and 1969 and in the hearings before Congressional Committees in 1971 and 1972. In contrast, at the *19b–3 Hearings*, the existing system had few defenders. Those who opposed the proposed rule largely confined themselves to either asking for delay, or suggesting that the initiation of competitive commission rates should await a more prosperous period, or be deferred pending the taking of certain further steps toward a central market system, or the adoption of certain proposed safeguards for the auction market process.[43] A few witnesses suggested that some vaguely outlined better system of fixed commission rates should be developed. No one supported any extended continuation of the status quo at least with respect to public rates.

The foregoing does not reflect any judgment by the Commission that the fixed minimum commission rate always was bad or that it was, or now is, illegal, or that fixed commissions could never be appropriate in the future. Rather, it simply reflects a conclusion, based upon the Commission's experience and the abundant data alluded to earlier that, under the conditions now existing, fixed minimum commissions should terminate at the times specified in the rule. It is not possible to predict future developments or future conditions and it is conceivable that unforeseen developments could require the Commission to reinstitute some form of fixed rates, although the Commis-

[43] *See infra* "Comments on the Rule."

sion does not anticipate or believe that this will become necessary.

3. Comments on the rule

In addition to a number of comments urging prompt adoption of Proposed Rule 19b–3,[44] a number of comments were recived either opposing its adoption or suggesting changes in timing to allow for other developments or to await improved economic conditions, or urging that other action be taken by the Commission in conjunction with its adoption. The princi-

[44] *See, e.g.*, statements at *19b–3 Hearings* by Representative William S. Stuckey, Jr., United States House of Representatives; James H. Lorie, Professor of Business Administration, University of Chicago; Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University; Marshall E. Blume, Professor of Finance, University of Pennsylvania; Donald Farrar, Professor of Finance, University of California, Los Angeles; Walter Werner, Professor of Law, Columbia University; Richard West, Dean, University of Oregon; David L. Ratner, Professor of Law, Cornell University; Robert Loeffler, Trustee, Equity Funding Corporation of America; James B. Halpern, of Arent, Fox, Kintner, Plotkin and Kahn; Philip G. Conner, Executive Vice President of Conner, Redwine, Inc.; Mark M. Batatian, President, Prudential-American Securities, Inc.; Charles T. Bauer, Chairman, Committee of Investment Officers, American Insurance Association. Comments of the United States Department of Justice, Dec. 10, 1974.

In addition, a number of letters supporting prompt adoption of the rule were received subsequent to the *19b–3 Hearings*. *See, e.g.*, letters from Senator Harrison A. Williams, Jr., Chairman of the Senate Subcommittee on Securities (Dec. 16, 1974); Senator Philip A. Hart, Chairman of the Senate Subcommittee on Anti-trust and Monopoly (Dec. 17, 1974); Representative John E. Moss, Chairman of the House Subcommittee on Commerce and Finance (Dec. 16, 1974); Representative Peter W. Rodino, Jr., Chairman of the House Subcommittee on Monopolies and Commercial law (Dec. 18, 1974); and William R. Salomon, Salomon Brothers.

pal arguments for permitting fixed minimum commission rates to continue were the contentions that the brokerage industry is subject to "destructive competition," that the fixed commission rate structure provides desirable subsidies which cause the securities markets to operate more efficiently and fairly and that the existence of a fixed commission rate, by encouraging membership on exchanges, is desirable to promote self-regulation.

The proposition that the brokerage industry, if subjected to competitive commission rates, would be susceptible to destructive competition was first elaborated in 1968; and it was again urged, in opposition to Rule 19b–3. The economic prerequisites for the type of destructive competition postulated are, however, the existence of fixed costs constituting a high percentage of total costs, and the availability of economies of scale applicable to a substantial percentage of an industry's aggregate production. Under those circumstances, it is argued that price competition, during periods of low demand and excess capacity, may be expected to drive prices down to marginal costs, which would be below average costs, resulting in losses for a large part of the industry. Eventually such conditions would result in a contraction of industry capacity to a level below that which is necessary to supply the public need and an undue degree of concentration in the brokerage industry which would have adverse effects on the functioning of the securities markets.

The possibility of destructive competition in the brokerage industry has been, since 1968, subject to careful analysis by a number of independent economists.[45] These analyses demonstrate that the brokerage

[45] *See, e.g.*, Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public*, 22 Stanford L. Rev. 675 (1970);

industry's fixed costs are not high in relation to its total costs even though fixed costs have sharply increased since 1968 and that there are no economies of scale which should lead to undue concentration with competitive commission rates. It has also been pointed out that, above a critical level necessary to provide modern electronic facilities by contract or otherwise, other forms of competition such as service competition could be expected eventually to have effects similar to those of price competition so that a fixed commission rate system, absent controls on the type and quantity of services, does not assure that there will not be increasing concentration in the brokerage industry.[45] Experience with competitive commission rates on large transactions since April, 1971, and on small transactions since April, 1974, has tended to bear out the analysis that the brokerage industry is not subject to destructive competition as postulated.

Coupled with the destructive competition argument has been an acknowledgment that any now fixed commissions would have to be based on costs with suggestions that the Commission develop the necessary analysis. To date the exchanges have not devised a system for allocating costs between stock exchange commission business and other business not involving fixed rates; furthermore, they have been reluctant to adopt schedules recommended on the basis of available cost

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Friend and Blume, *Competitive Commissions on the New York Stock Exchange*, 28 The Journal of Finance 795 (1973); Mann, "A Critique of the New York Stock Exchange's Report on the Economic Effects of Negotiated Commission Rates on the Brokerage Industry, the Market for Corporate Securities, and the Investing Public" *Rate Structure Hearings* (1969); West and Tinic, *Minimum Commission Rates on New York Stock Exchange Transactions*, 2 Bell Journal of Economic and Management Science 577 (1971).

[45] *See* Friend and Blume, *supra* n. 43.

data.[47] A number of brokerage firms have repeatedly indicated that it is impractical to allocate expenses so as to break down net income among such varied lines of business as securities commissions, underwriting and trading profits since substantially the same sales personnel and branch office facilities are engaged in the generation of all sources of revenues at any time, and it is not practicable to allocate to each revenue source its share of such joint expenses as personnel costs, occupancy and equipment costs, interest and communication costs.

On the basis of its experience over the last six years with the problems of analyzing costs for a brokerage industry in many different lines of business, the Commission has concluded, as noted above, that commitment of resources would not be justified in view of the strong probability that no such system would work as well as competition.[48] The brokerage industry has demonstrated for a number of years that it can deal with price competition. Initially, such competition was confined to the use of the complex rebative practices which developed because the fixed commission rate structure was out of line with perceptions of cost. Since April, 1971, competitive commission rates for large transactions have been given formal recognition in the rate structure, and since April, 1974, competitive commission rates have been in effect for small transactions.

The second argument for retaining fixed commission rates is that they provide a number of subsidies which are beneficial to the operation of the securities markets.[49] Thus, it is said that large investors should pay

[47] *See supra* n. 22 and accompanying text.

[48] *See supra* "Reasons for the Rule."

[49] *See, e.g., Statements at Intra-Member Rate Hearings* by representatives of the NYSE, the American Stock Exchange, and the Securities Industry Association; and Satements at *19b–*

commissions which are in excess of those justified by costs thereby enabling brokers to hold commission rates for small investors down to reasonable levels. The participation of small investors, which would be encouraged by lower commission rates would, it is asserted, enhance the orderliness and liquidity of the market for securities.

Many brokerage firms, however, concentrate on servicing large institutions while others concentrate on a retail business for small investors. Firms that do both a retail business and an institutional business have tended to treat the two as separate operations; each operation is in effect selling a different product and selling it to customers with fundamentally different needs. Brokerage firms are not obligated to do business at the request of the public and may decline, for example, to handle the accounts of small customers. Consequently, revenues derived from institutional business do not provide any rational, controllable subsidies to small investors.

It has also been argued that minimum commission rates, since they provide a relatively dependable stream of revenue to regional brokers, particularly small brokers, enable them to operate profitably. Their continued existence is said to be dependent on profits derived from fixed commission rates and to be important in order to maintain a nationwide distribution network for newly issued securities as well as to provide regional underwriting capabilities for local enterprises. While it may be argued that commission rates should be kept artificially high to sustain regional brokers in times of few underwritings so that they

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3 Hearings by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; and by representatives of the Association for the Preservation of the Auction Market, Inc., the NYSE, the American Stock Exchange, and the Securities Industry Association.

may be available when needed to distribute new offerings, underwriting is recognized as profitable business for a brokerage firm, there have always been adequate resources to devote, in light of the demand, to underwriting activities and many regional brokers appear confident of their ability to operate without minimum commission rates. Nevertheless, it is possible that some firms are not large enough to operate efficiently. To that extent there may be a continuation in the current pattern of consolidation of firms after the introduction of competitive commissions.

It has also been argued that minimum floor brokerage commissions are desirable because they maintain excess capacity on exchange floors during slack periods in order to meet peak demands. There are not, however, concomitant obligations on exchanges or their members to maintain any particular level of floor brokerage capacity. Consequently, capacity is not maintained except to the extent that individual exchange members believe it desirable in order to meet expected demand.

With respect to market making by specialists, it is argued that floor brokerage income realized from high volume securities enables the specialist to make a better market in low volume securities. But it has never been possible, in the view of exchanges and specialists, to measure the quality of markets with any degree of precision so as to determine that any incentive provided by minimum floor brokerage commissions is being used to provide better markets. It has consistently been acknowledged that the type of market maintained for a security is dependent upon its individual trading characteristics which may vary from time to time so that there is not any way to monitor the use by specialists of any incentive provided. Fur-

thermore, the system of allocating and reallocating stocks to specialists has not been designed for the purpose of distributing floor brokerage among different specialists on any basis likely to make efficient use of the incentive. Secondly, securities listed on exchanges are required to meet listing criteria designed to provide reasonable likelihood of sufficient trading volume so that the exchange system will operate effectively.

The third argument for maintaining fixed commission rates is that they provide an incentive for membership on exchanges and that the exchange revenue derived from the orders executed on exchanges supports desirable self-regulation of the brokerage industry. The advent of competitive rates, it is argued, may lead to an exodus from exchanges of members which could effectively negotiate access to the exchange when necessary and would otherwise make separate markets off the exchanges.

Market making requires the commitment of capital so that, to the extent exchanges operate as efficient market places, brokers will be less likely to make the necessary investment to engage in their own market-making activities. With respect to the possible loss of membership in the case of brokers which prefer to negotiate access to exchange facilities, exchanges have authority to provide appropriate regulation for such transactions. Furthermore, exchanges may impose revenue charges to support their activities which, if not borne directly by brokers which negotiate access, will nevertheless be passed on indirectly to them through charges made by members. If transactions in listed securities take place off exchanges to a greater extent than is now the case, the associated self-regulatory costs will be shifted to a national securities associa-

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tion. Finally, developments of this kind are among the matters which may be monitored and dealt with if they arise, as discussed below.[50]

Representatives of several exchanges, as well as several other witnesses at the *19b–3 Hearings*,[51] suggested that current economic conditions should lead to a postponement of the introduction of competitive commission rates. It is argued that the transition should be timed to a period of general prosperity so as to allow the securities industry a margin for error in making the necessary adjustments for competitive commission rates. There is not, however, any assurance of successfully predicting the general level of the economy, or of stock volume and stock prices. Furthermore, if a decision were to be made on the basis of predictions, after the decision became effective there could be a change in the trend of the economy, or of stock market volume and stock prices independent of the general state of the economy.

Similarly, there have been recent periods of high stock market volume and stock prices when it would have been unwise to introduce competitive commission rates; during the paperwork crunch in 1969 and 1970 there might have been substantial risks to investor protection, notwithstanding relatively high volume and prices for most of that period. Developments since

[50] Furthermore, with the advent of the consolidated tape, any broker choosing to make its own markets in listed securities would have to ensure appropriate reporting. *See Silver* v. *New York Stock Exchange*, 373 U.S. 341, 356 (1963), with respect to regulation by exchanges of non-members.

[51] *See, e.g.*, statements at *19b–3 Hearings* by Sanford I. Weil, Chief Executive Officer, Shearson Hayden Stone, Inc.; James M. Roche, Public Director of the NYSE; and representatives of the American Stock Exchange, Midwest Stock Exchange and the Securities Industry Association.

1970, such as implementation of the Securities Investor Protection Act,[52] revision of financial responsibility rules,[53] implementation of new rules with respect to custody of customer funds and securities[54] and improved surveillance procedures[55] have substantially reduced those risks.

On the other hand, some commentators suggested that there would be a better opportunity to observe adverse consequences, if any, and take action to correct them during a period of relative lack of activity in the industry. Finally it was suggested by others that there would be transitional problems of roughly the same magnitude whenever the transition took place, and, therefore, no effort should be made to tie the transition to particular economic circumstances.[56]

The most important consideration is that the brokerage industry should be given, as it has been, a substantial period of time to plan for the transition rather than attempt to time the change precisely with respect to particular economic circumstances. That was the principle which motivated the Commission to announce, in September, 1973, its policy conclusion

[52] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation, established by the Securities Investor Protection Act, had by the end of 1973, placed 94 firms in liquidation. Securities Investor Protection Corporation, *Third Annual Report 1973*, at 1 (1974).

[53] *Compare* NYSE Rule 325 as in effect until 1970 *with* such rule as in effect subsequently.

[54] Rule 15c3–3 under the Securities Exchange Act of 1934, 17 C.F.R. 240.15c3–3.

[55] *See* Securities Investor Protection Corporation, *Third Annual Report 1973*, at 16–17 (1974).

[56] *See, e.g.*, statements at *19b–3 Hearings* by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University, and Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated.

that the fixing of commission rates should be terminated after April 30, 1975.

It was also urged that a number of other steps be implemented concurrently with or prior to the introduction of competitive commission rates. Suggestions included: (a) adoption of a best execution rule;[57] (b) development of a composite quotation system and improved nationwide clearance and depository system;[58] (c) possible safeguards to maintain viability of regional exchanges and third markets;[59] (d) preservation of the auction market by providing "equal regulation" for aspects of the securities business;[60] (e) alteration of other rules of exchanges which have anti-competitive aspects;[61] (f) prior action to lower costs on small transactions;[62] (g) prohibition of affil-

[57] *See, e.g.*, statements at *19b–3 Hearings* by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University; Donald Farrar, Professor of Finance, University of California, Los Angeles; and representatives of the Boston Stock Exchange.

[58] *See, e.g.*, statements at *19b–3 Hearings* by Daniel J. Murphy, Senior Vice President, Shields Model Roland, Incorporated; and representatives of the Boston Stock Exchange, Midwest Stock Exchange and PBW Stock Exchange, Inc.

[59] *See, e.g.*, statements at *19b–3 Hearings* by Donald Farrar, Professor of Finance, University of California, Los Angeles; Mark Batatian, President, Prudential-American Securities, Inc.; and representatives of the PBW Stock Exchange, Inc., and the Investment Counsel Association of America.

[60] *See, e.g.*, statements at *19b–3 Hearings* by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; and representatives of the Midwest Stock Exchange and the NYSE.

[61] *See* statement at *19b–3 Hearings* by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University.

[62] *See, e.g.*, statements at *19b–3 Hearings* by Mark Kaplan, President, Drexel Burnham & Co., Inc. and Thomas E. O'Hara, Chairman of the Board of Trustees of the National Association of Investment Clubs.

iated business;[63] (h) adoption of rules to resolve possible questions as to the scope of the term "investment adviser" under the Investment Advisers Act of 1940 and of the term "member" under the Act;[64] (i) action to clarify the "fiduciary" question;[65] and (j) institution of a monitoring system to assess the impact of competitive commission rates.[66]

Some of the suggestions are intended to have the effect of preserving the competitive position of exchanges; others are designed to remove competitive disadvantages which are believed to impede the ability of existing participants in the securities markets to compete effectively without fixed minimum commissions. Still other suggestions link anticipated de-

[63] *See, e.g.*, statements at *19b–3 Hearings* by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; and by representatives of the Midwest Stock Exchange.

[64] *See, e.g.*, statments at *19b–3 Hearings* by Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated; and representatives of the Midwest Stock Exchange.

[65] *See e.g.*, statements at *19b–3 Hearings* by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; Hall Casparian, Vice President and General Counsel, William D. Witter, Inc.; Philip G. Conner, Executive Vice-President, Conner, Redwine Inc.; Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated; Daniel J. Murphy, Senior Vice President, Shields Model Roland Incorporated; Mark Kaplan, President, Drexel Burnham & Co. Incorporated; Honorable Gerald L. Parsky, Assistant Secretary of the Treasury for Trade, Energy, and Financial Resources Policy Consideration; Marshall Blume, Professor of Finance, University of Pennsylvania; James H. Lorie, Professor of Business Administration, University of Chicago; Robert Loeffler, Trustee, Equity Funding Corporation of America; and representatives of the Boston Stock Exchange, Midwest Stock Exchange, NYSE, American Insurance Association and Investment Counsel Association of America.

[66] *See, e.g.*, statements at *19b–3 Hearings* by representatives of the NYSE.

velopments in the efficient operation of the securities markets to the issue of competitive commission rates or anticipate problems with respect to the fair and orderly operation of securities markets.

With respect to adoption of a best execution rule, the Commission does not believe it necessary, solely because of the introduction of competitive commission rates, to formulate special principles to supplement existing standards as to the duty of loyalty and care owed by an agent to his principal under general principles of agency law, as currently supplemented by the provisions of the Act and the rules adopted thereunder. If, however, it should appear appropriate, after the introduction of competitive commissions and on the basis of experience with the evolution of the markets, to provide more particular rules, the Commission will consider doing so.

More efficient and wider dissemination of quotations as well as full implementation of the consolidated tape now in a trial phase, continue, in the Commission's judgment, to be appropriate in the context of the development of a central market system. In the view of the Commission the essence of the central market system is an interconnected system of communication. But the development of such a system or further improvements in the nationwide clearance and depository systems are not preconditions to the introduction of competitive commission rates; rather, competitive commission may, as suggested by some,[67] speed progress in their development.

While regional exchanges have been innovative and resourceful in developing new techniques and services for their members, some of them have also been ve-

[67] *See* statement at *19b–3 Hearings* by James H. Lorie, Professor of Business Administration, University of Chicago.

hicles for the evasion of minimum commissions. At least one regional exchange has indicated its confidence that it will be a viable marketplace without minimum commissions,[68] and the Commission does not believe it appropriate to afford special safeguards to regional exchanges solely to protect them against the effects of competitive commissions rather than for reasons relating to a desirable market structure. Similarly, to the extent that the third market has in effect existed because of the exchange umbrella of the minimum commission rate structure, the Commission does not therefore conclude that special protections are appropriate for the third market to further the objectives of the Act.

Suggestions for "equal regulation" for all aspects of the securities business came specifically from the NYSE. The NYSE would, among other things, require all trading in listed securities to be exposed to the auction market provided by any exchange[69] and would limit contact between dealers in listed securities and their customers as is currently done for specialists by NYSE and American Stock Exchange rules. The NYSE and American Stock Exchange rules restricting specialists from certain classes of customers have their regulatory foundation on the specialist's control of the limit order book from which he derives substantial income acting as an agent for other brokers. Similar circumstances do not exist for third

[68] *See* statement at *19b–3 Hearings* by representatives of the Midwest Stock Exchange.

[69] The Midwest Stock Exchange suggested requiring all trading of listed securities to be done on exchanges if exchange memberships dropped. Currently NYSE rules provide in a number of situations that a member need not take even its own transactions in listed securities to an exchange floor. *See* NYSE Rules relating to secondary distributions.

market dealers. Nevertheless, without such provisions it is suggested that the third market will expand to the detriment of the exchanges and the auction market they provide.

Other commentators have suggested that it is more reasonable to argue that minimum commission rates have had more to do with fostering the development of the third market than to argue that competitive rates will make the third market more important.[39] Since the effect of proposals to restrict third market dealers would be to put the third market out of business and consequently give exchanges a monopoly on trading in listed securities, such action would not appear to be appropriate without persuasive evidence based on experience with competitive commission rates that the objectives of the Act would thereby be promoted.

Alteration of other rules of exchanges which have anticompetitive effects was also suggested by commentators particularly concerned that regional exchanges might not survive in an environment of competitive commission rates. One commentator suggested requiring the NYSE to allow anyone to become a specialist in order to develop a system of competitive specialists on the NYSE. That suggestion is based on assumptions about future developments in the markets for listed securities as a consequence of introducing competitive commission rates; those developments may not come to pass and the Commission does not believe it necessary to take specific action in advance of any experience with actual developments.

[39] *See, e.g.*, statements at *19b–3 Hearings* by James H. Lorie, Professor of Business Administration, University of Chicago, and Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University.

With respect to small transactions, it may not be possible to reduce costs without changes in the manner in which securities transactions are effected; certain kinds of costs do not vary with the amount involved in a transaction and must be incurred. To the extent, however, that better cost controls and improved procedures for processing transactions, including the elimination or immobilization of stock certificates, can be developed, their development will be speeded by the introduction of competitive commission rates and impeded by retention of a minimum commission rate system in which rates are automatically increased to pay for increasing costs.

It was also urged that, prior to implementation of a system of competitive commission rates, any handling of affiliated business by exchange members should be prohibited outright in place of the current provisions of Rule 19b–2 [11] which require that 80 percent of an exchange member's business not be affiliated business. In adopting Rule 19b–2 the Commission recognized that it should gain some administrative experience in its operation and impact so that it might reassess its position should harmful, unforeseen consequences arise. The current formulation provides flexibility to respond to any fundamental changes attributable to operation under competitive commission rates, which will greatly reduce the significance of the so-called "institutional membership" problem.

The fiduciary question referred to above, arises out of the expectation by many observers that institutional portfolio managers, who purchase a very large part of all brokerage services, may believe themselves compelled, after the introduction of competitive commission rates, to seek the lowest available commission rate. It is believed that institutions would so act out of

[11] 17 C.F.R. 240.19b–2.

fear of lawsuits alleging breach of fiduciary duty if they used their beneficiaries' funds to pay more than the lowest available commission rate. Paying the lowest available commission rate would, it is argued, protect the institutional portfolio manager from liability. Fiduciaries, however, purchase other services for their beneficiaries without believing themselves compelled to seek the lowest possible cost; rather they appropriately "consider the full range and quality" of the services which accrue to their beneficiaries and "need not solicit competitive bids." [72]

In this connection, it has been suggested that fiduciaries might feel compelled to pay commissions which were so low as to make it impossible for brokers to supply research which is urgently needed by these fiduciaries and their beneficiaries. The Commission does not believe that this will occur to any material extent since fiduciaries are entitled to exercise their judgment as to what is in the interest of their beneficaries and, in any event, the cost of research does not appear to be so large a part of the expense incurred by brokerage firms as to make it impossible for them to supply it in reasonable quantity if their customers desire it.[73] While there may be some period

[72] *Cf.* Securities Exchange Act Release No. 9598 (May 9, 1972), 37 Fed. Reg. 9988 (May 18, 1972).

[73] Member firms' 1973 NYSE Income and Expense reports (which include an estimate of research expense covering all research activities wherever performed) show that, of the 235 firms carrying public customer accounts, 4 estimated research expense as 25 percent or more of total expense, 12 or more than 15 percent, and 26 firms as more than 10 percent. The aggregate research expense of these 26 firms was $20 million out of a total of $109 million for all 235 carrying firms. There were 180 firms for which research expense was estimated to account for less than 5 percent of total expense; but the research expenditures of these firms accounted for 65 percent of the total for all carrying firms.

of adjustment for fiduciaries after the introduction of competitive commission rates for all transactions, experience has to some extent already built up in arriving at commissions on the portion of orders over $300,000, which have most frequently involved fiduciaries. That experience should eventually be capable of general application.

Questions relating to the definition of investment adviser under the Investment Advisers Act of 1940 may require analysis based on experience with competitive commission rates. The questions raised relating to the scope of the definition of member under the Act are not basically new, but were not considered to require specific action in connection with the introduction of access provisions for non-member brokers. The Commission, as indicated below, is, however, prepared to consider further specific proposals with respect to those questions as well as the fiduciary question and other suggestions made at the *19b–3 Hearings.*

The Commission was also requested to undertake a monitoring system to assess the impact of competitive commissions. The Commission proposes to take steps to provide appropriate increased monitoring of the activities of brokers, and their financial condition and operations as well as possible shifts in patterns of trading for some period subsequent to May 1, 1975, in order to assure that the objectives of the Act, including the protection of investors and the maintenance of fair and orderly markets, are upheld during any transitional phase. Such monitoring may include collection of additional financial data as well as programs of staff interviews to evaluate changing conditions. In that connection the Commission will welcome specific suggestions for the types of activities on which monitoring efforts should be focused. In addi-

tion, the Commission will consider whether or not any rulemaking or other action would be appropriate to clarify the application of the definition of member in order to assist exchanges in performing their self-regulatory role and will consider questions as to incentives to exchange membership and problems for fiduciaries anticipated by some commentators. As to the fiduciary question the Commission will, of course, also submit comments on provisions in pending legislation.[74] Any such action, if appropriate, could be taken prior to May 1, 1975, in order to facilitate the transition.

Stated differently, certain persons suggested that the introduction of competitive rates would have undesirable and unintended consequences, in part because of the changes which it would create in the economic incentives and choices of member firms. The Commission believes that these concerns appear exaggerated. In any event, however, the possibility of such undesirable consequences does not provide an adequate basis for deferring competitive rates, since there are other ways in which these problems can be dealt with. The monitoring efforts which the Commission intends to undertake will enable it to be alert to developments and to position itself to take prompt corrective action if undesirable consequences develop before, or after, May 1, 1975. Thus, for example, if it should appear that member firms are proposing to leave the exchanges in order to execute customers' transactions by making markets off the exchange, various steps could be taken to restrict this practice to the extent necessary or appropriate in the public interest or for the protection of investors.

In that connection, the Commission intends shortly

[74] H.R. 10 and S. 249, 94th Cong., 1st Sess. (1975).

to announce procedures by which any interested person may offer suggestions concerning appropriate methods to deal with any problems that might emerge. It should be noted, however, that proposals which appear on their face to be anticompetitive, can hardly be acted upon in the absence of experience under competitive rates which demonstrates that they are, nevertheless, necessary or appropriate.

4. Conclusion

After a long and careful consideration of the policy questions raised by the existence of the fixed commission rate structures on national securities exchanges, the Commission has concluded that the adoption of Securities Exchange Act Rule 19b–3, precluding exchanges from fixing the rates of commission their members must charge, is necessary or appropriate for the protection of investors, to assure fair dealing in securities traded in upon such exchanges and to insure the fair administration of such exchanges, and, accordingly, hereby adopts Rule 19b–3.

5. The text of the rule

The text of Rule 19b–3, as adopted, is as follows:

Rule 19b–3. Prohibiting Fixing of Rates of Commission by Exchanges

(a) No national securities exchange ("exchange") shall adopt or retain any rule of the exchange that requires, or shall otherwise, directly or indirectly, require its members, or any person associated with its members, to charge any person any fixed rate of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(b) Each such exchange shall provide in its rules of the exchange that nothing therein or in

its practices shall be construed to require or authorize its members, or any person associated with its members, to agree or arrange, directly or indirectly, for the changing of fixed rates of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(c) No member of any exchange, or person associated with any member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange covered by paragraph (a) of this rule.

(d) As used in this rule, the term "rule of the exchange" refers to any provision of the constitution, articles of incorporation, bylaws or rules or instruments corresponding thereto, whatever the name, of the exchange, and the term "floor brokerage commissions" refers to commissions applicable to the execution of transactions for members or associate members of an exchange but does not include commissions for clearance services or commissions for a combination of floor brokerage and clearance services.

(e) The provisions of this rule shall become effective on May 1, 1975, except as to any rule of the exchange relating to floor brokerage commissions as to which the provisions of this rule shall become effective on May 1, 1976.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 9351

The Securities and Exchange Commission today announced that it has sent the following letter to the New York Stock Exchange in response to the latter's commission rate proposal of June 28, 1971:

SEPTEMBER 24, 1971.

MR. ROBERT W. HAACK,
President, New York Stock Exchange,
New York, N.Y.

DEAR MR. HAACK: The Commission has reviewed the proposed commission rates submitted by the New York Stock Exchange on June 28, 1971 pursuant to Rule 17a–8 and in light of the evidence presented at the public hearing on the proposal. As the Exchange has recognized, a rule dealing with commission rates is necessarily dependent for its validity upon the continuation of the conditions and circumstances justifying the reasonableness of the rates. Accordingly, the Commission expects that the Exchange will review its commission rate structure on a regular and systematic basis and will submit any appropriate modifications or changes in such structure to the Commission to enable it to exercise its continuing regulatory oversight. The Commission expects the Exchange to con-

tinue to gather necessary data from its members for this purpose. The Commission will also continue its monitoring program in order to assess the need for any rate changes.

As regards the present rate proposal, the inability of the Exchange appropriately to allocate costs and revenues between brokerage and other activities of its members has necessitated our consideration of the proposed rates on the basis of the total financial experience of Exchange member firms. We have considered the problems experienced by the securities industry in dealing with widely fluctuating volume levels in recent years, leading to back office problems and, in some cases, the insolvency of member firms. We find that the profitability of member firms during the first half of 1971 appears to be reasonable in view of significant changes in the operation and structure of the industry, including the introduction of competitive rates on certain large transactions, the forthcoming rules to protect customers' funds and securities and greater access by nonmember broker-dealers to the facilities of the Exchange. The Commission is continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. Accordingly, we reserve this matter for later determination in light of the evidence which is being developed.

On the basis of the evidence presented to us and the factors discussed above, the Commission does not object at this time to implementation of the Exchange's proposed rates, subject to the following conditions:

1. The present surcharge on certain transactions will be terminated as to all such transactions as soon as the Exchange, consistent with price restrictions re-

ferred to in subparagraph 10, may implement the new rate proposal.

2. In order to provide small investors with the continued opportunity to participate in the securities markets, no member organization that has traditionally handled small customer accounts will impose or continue any limitation of any kind on the size or frequency of any such customer's orders or the size of his account, nor will any member organizations impose fees, commissions or other charges on any such customer in excess of the proposed rates. The Exchange will establish an Investors' Service Bureau to assist small investors to participate in the markets, and will undertake a comprehensive and continuing effort to facilitate service to the small investor.

3. The rate schedule will be revised to provide that the total commission on an order consisting of a round-lot plus an odd-lot will not be higher than the commission on the next higher round-lot.

4. The intra-member rate will be reviewed by the Exchange in order to determine whether fixed charges should continue to prevail in this area. As regards the intra-member rate incorporated in the NYSE rate proposal, the Commission does not object at this time to that part of the proposal subject to the continuing consideration and review of the long-run desirability of the continuation of fixed intra-member charges and to the Commission's consideration of the industry structure questions in the hearings commencing October 12, 1971 and to the other conditions noted below.

5. The Commission finds that the provision for 30% access is inadequate and that the discount afforded nonmember broker-dealers should be not less than 40% to allow for a minimum meaningful test of this proposal. The Commission is reserving its final deter-

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mination regarding the "primary purpose" limitation of the access provision until the completion of its scheduled hearings. The Commission will reconsider the access provision, including its "primary purpose" limitation, after the conclusion of the hearings scheduled to begin October 12, 1971. The Commission finds inappropriate the condition that it enforce the anti-rebate provisions of the Exchange's agreements for access by nonmembers. The responsibility for enforcing a rule adopted by a self-regulatory organization lies with that organization and the Commission's regulatory oversight will be exercised only to ensure that the rule and its administration by the self-regulatory organization are appropriate.

6. The Exchange will continue to ensure that commission revenues are prudently applied by all member organizations so as to improve further their capital positions and operational facilities.

7. The Exchange will, on or before May 1, 1972, submit to the Commission its proposals for implementing uniform reporting by member firms in order to permit evaluation of subsequent commission rate proposals, if the Exchange is unable to devise a suitable reporting mechanism, the Commission will consider doing so pursuant to Section 17(a) of the Securities Exchange Act.

8. The Exchange will examine its definition of an "order" to determine whether to alter the present provision so that portions of the same order executed on different days would be aggregated for purposes of ascertaining the applicable commission rate.

9. The Exchange will adopt rules or rule changes to enable member firms to enter into cooperative arrangements under which execution and clearance functions of such firms could be performed jointly with-

out the payment of intra-member rates for such functions to any other member.

10. The Exchange will comply with any restrictions on price increases imposed by law, as interpreted by the President's Cost of Living Council or any other organization designated by the President or the Congress to impose or interpret any such restrictions.

Sincerely yours,

WILLIAM J. CASEY,
Chairman.

Before the Securities and Exchange Commission,
Washington, D.C.

FILE NO. 10-54-1

PROPOSED RULES OF THE CHICAGO BOARD OPTIONS EXCHANGE

COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

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JANUARY 15, 1973.

The Commission has requested public comment on the proposed rules of the Chicago Board Options Exchange, Inc. ("CBOE") which is seeking registration as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934. In response to this invitation, we wish to comment on proposed Rule 14 which fixes minimum rates of commission for transactions executed on the CBOE.[1] We believe that this rule is subject to serious objection on antitrust and public policy grounds.

[1] Our silence with respect to the other proposed rules of CBOE implies neither approval nor disapproval.

The Commission is well aware that fixed minimum rates of commission raise serious questions under the antitrust laws. *Thill Securities Corp.* v. *New York Stock Exchange*, 433 F. 2d 264 (7th Cir. 1970), *cert. denied*, 401 U.S. 994 (1971). Based on evidence accumulated by the Commission and the courts, the Department of Justice has taken the position that fixed minimum rates are not necessary to achieve any goal of the securities laws and therefore violate the antitrust laws under the doctrine of *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963). We have expressed this opinion in several memoranda submitted to the Commission during the last five years' commission rate and market structure proceedings[2] and have actively advocated this position as a party to the *Thill* litigation. In addition, we have filed an antitrust suit against the Chicago Board of Trade seeking injunctive relief against the fixing of minimum commission rates on that leading commodity exchange, the sponsor of the new CBOE.[3]

There is a trend toward eliminating the traditional fixed rates on various exchanges—or stated alternatively there has been no showing that fixed commissions are necessary to make any exchange system work. *Cf. Silver* v. *New York Stock Exchange*, 373 U.S. at 357. The Commission has eliminated fixed commission rates on securities transactions of large size on existing registered national securities exchanges and has promised to lower the size of the transaction subject to negotiated rates in the future.

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[2] See *Memorandum of the Department of Justice on the Fixed Minimum Commission Rate Structure*, SEC File No. 4-144 (January, 1969); *Statement of the United States Department of Justice*, SEC File No. 4-147 (December, 1971).

[3] *United States* v. *Board of Trade of the City of Chicago*, Civil No. 71C2875 (N.D. Ill.).

The Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, has recommended that all fixed rates be eliminated.[4] Within the securities industry itself, a growing number of prominent persons have recommended the elimination of fixed rates.[5]

A parallel trend can be seen on the nation's commodity exchanges. Most of the larger exchanges have agreed, in settlement of antitrust suits, to phase out entirely fixed commission rates over a period of several years.[6] The Administrator, Commodity Exchange Authority, after careful study, concluded that the orderly elimination of fixed rates would prove beneficial to traders on commodity exchanges without adverse consequences to the brokerage industry.[7] A recently organized commodity exchange, at the urging of the administrator, deleted fixed minimum rates from its proposed rules.[8]

These developments suggest that it would be highly undesirable for the Commission to approve fixed commission rates on a new exchange which is about to be registered. Even if it is appropriate to allow a prompt but gradual phase-out of fixed rates on established

[4] Securities Industry Study Report of the Subcommittee on Commerce and Finance, Committee on Interstate and Foreign Commerce, House of Representatives, Aug. 23, 1972, pp. XIV; 131–146.

[5] See *Statement of the United States Department of Justice, supra*, pp. 6–8.

[6] See documents filed in *Arenson* v. *Chicago Mercantile Exchange*, Civil No. 71C854 (N.D. Ill.).

[7] See *A Report on the Rules and Practices of the Chicago Board of Trade Concerning Minimum Rates of Commission and Brokerage Fees*, Administrator, Commodity Exchange Authority July, 1972.

[8] See Rules of the Pacific Commodities Exchange, Inc. on file with the Commodity Exchange Authority.

exchanges, this cannot justify present approval (or non-disapproval) of fixed rates for exchanges not yet in existence. Such a course would be plainly contrary to the broad public interest in a competitive economy. See *U.S.* v. *Philadelphia National Bank*, 374 U.S. 321, 372 (1963); *Thill; supra.* It would also—unwisely—expose the members of the CBOE to possible treble damage liability under the antitrust laws. While there may be some question about the appropriateness of such damages for long established practices of existing exchanges,[9] no considerations of laches, estoppel or reliance would be present in the case of the CBOE.

We therefore request that the Commission disapprove proposed Rule 14 of the CBOE on the ground that it unnecessarily interferes with competition. Cf. *Thill*, 433 F. 2d at 271–2; *Rules of the New York Stock Exchange*, 10 S.E.C. 270 (1941). In the alternative, if it grants approval, (or non-disapproval), we request that it formally notify the Department of Justice of (i) the reasons for its action, and (ii) the legal status of the rule under the securities laws. See *Ricci* v. *Chicago Mercantile Exchange*, (Supreme Court, Jan. 9, 1972) slip opinion, p. 15, fn. 14.

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Antitrust Division.

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JANUARY 15, 1973.

[9] See Comments of Judge Swgert in *Thill*, 433 F. 2d at 277.

Securities Exchange Act

Release No. 9985, February 1, 1973

In the Matter of the Chicago Board Options Exchange, Inc.

Findings and Opinions of the Commission

The Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange"), a Delaware non-stock corporation organized to establish an auction market dealing in put and call options, filed with us an application for registration as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934 ("Exchange Act").[1] In response to public notice of the filing of the application and our invitation for comments thereon, certain comments were submitted to us by the American Stockholders Association, Inc., the American Stock Exchange and the Antitrust Division of the United States Department of Justice, all of which have been carefully considered.

Under Section 6(d) of the Exchange Act we are required to cause an exchange applying for registration to be registered as a national securities exchange if it appears to us that the exchange is so organized as to be able to comply with the provisions of the Act and the rules and regulations thereunder and

[1] Pursuant to the Exchange's consent, action on its application as amended has been deferred pending the issuance of these findings and opinion.

that the rules of the exchange are just and adequate to insure fair dealing and to protect investors.

After a review of CBOE's application in accordance with these standards, we have determined to grant the registration of the Exchange. In taking this action, we note that the CBOE will not be able to commence exchange operations immediately, since it appears that it will first be necessary for the Exchange (or its subsidiary, The Chicago Board Options Exchange Clearing Corporation, which is the issuer of the options to be traded on the Exchange) to effect compliance with the registration requirements of the Securities Act of 1933 and of Section 12(b) of the Exchange Act with respect to the securities for which it proposes to provide an exchange market. Exchange officials are engaged in discussions with our staff with a view to such compliance, the CBOE has agreed to make appropriate filings pursuant to those provisions, and the Exchange's application for registration includes as one of its "stated policies"[2] that it will comply with the registration provisions applicable to the securities to be traded on the Exchange.

We do not believe it is necessary to describe herein the rather voluminous rules and representations of the Exchange which have been filed with us as a part of its application. We do believe, however, that special mention should be made of several of the policy issues considered by us in connection with our review of the CBOE application.

1. Since the CBOE is a new exchange, and the first national securities exchange proposing to provide for

[2] Rule 17a–8 under the Exchange Act, which requires any proposed changes in exchange rules to be submitted to us before being put into effect, defines "rules" to include an exchange's "stated policies."

the trading of puts, calls, or similar options, we have determined to permit it to test the market for such options within a controlled environment. CBOE has stated that it intends to commence operations as a "pilot project" and limit trading on its floor initially to call options in respect of approximately 30 underlying stocks, and increase the number of underlying stocks gradually and extend operations to other types of options as experience is gained and the market and its regulatory arrangements are tested. Also, the Exchange has provided in its rules that the securities underlying the call options must be registered and listed on another national securities exchange and have broad distribution and volume characteristics.[3]

The Exchange has further agreed not to extend its activities to include trading in put options without complying with applicable procedures governing the adoption of new rules by national securities exchanges. These representations and policies announced by the Exchange are, in our view, "rules" of the Exchange and as such will be subject to our review prior to any material change therein. In this connection, we have recently proposed adoption of Rule 9b–1 under the Exchange Act which would provide special procedures relating to the adoption and alteration of rules of registered national securities exchanges concerning "acts or transactions in options."[4] In any event, we intend to maintain close surveillance over the progress of CBOE's "pilot project." For the period of CBOE's experimental status, and in line with the need to maintain flexibility in regulating this new kind of exchange

[3] CBOE Rule 5.3.

[4] Securities Exchange Act Release No. 9930 (January 9, 1973).

market,[5] we have also decided to postpone a definitive determination as to whether CBOE should be required to include in its rules a nonmember access provision.[6] CBOE rules do not now include such a provision.

2. We have also considered the question of CBOE's rules regarding fixed commission rate charges. Under Chapter XIV of its rules, CBOE has adopted a policy of permitting negotiated commission rates on all orders to purchase or sell options having premiums above $30,000, and on orders for exercise of exchange options having a value of more than $30,000 (as measured by the striking price multiplied by the number of shares). It has been suggested by one commen-

[5] As we stated in our release announcing proposed Rule 9b–1:

"The Commission is of the opinion that in addition to the novelty of exchange option trading, such trading may involve complex problems and special risks to investors and to the integrity of the marketplace. The Commission therefore believes that, utilizing the broad power granted under Sections 9 and 23 of the Act it should provide itself with a substantial amount of flexibility in carrying out its regulatory responsibilities with respect to option trading on exchanges." [Footnotes omitted.]

[6] "Nonmember access" involves the granting of a percentage discount from the fixed exchange commission rate to nonmember brokers when they trade as agents in listed securities through members on that exchange. Rules providing for such access have been adopted by the other national securities exchanges. Those exchanges do not at present trade in put and call options. We also note that the adoption of nonmember access rules by those exchanges was occasioned mainly by the fact that a great many nonmembers who wished to effect transactions for their customers in listed securities were economically inhibited from doing so by prior exchange rules which prohibited their sharing in the stock exchange commissions generated. If CBOE's experiment is successful and a similar desire for access by nonmembers develops, we will reconsider the question of whether it is appropriate for CBOE to adopt a nonmember access rule.

tator[7] that we should not approve CBOE's rules unless they also provide for negotiated commission rates below the $30,000 level.

In reviewing CBOE's registration application, we have weighed its particular rule provisions against the regulatory objectives of the Exchange Act. Among other things, those objectives embody the concept that exchanges will deal fairly with the public; that exchanges will be organized in such a fashion as to ensure their continued viability in asserting self-regulatory oversight over their members; and that exchanges may, so far as is consonant with other regulatory objectives of that Act, maintain competitive viability with other exchanges. Applying these criteria, we find it in the public interest to declare effective the registration of CBOE on the basis of its present rules, including its rule regarding commission rate charges.

We have been engaged for some time in a painstaking review of the commission rate structure of all national securities exchanges. As a result of that review, we have concluded that fixed commission rates on institutional-sized orders no longer serve any compelling regulatory objective of the Exchange Act and have required each of the existing exchanges to expand the permissible negotiation of commission rates to that portion of securities orders exceeding $300,000.[8] We also have indicated our intention to consider whether this breakpoint on negotiated commission rates should not be lowered to $100,000 provided our analysis of the impact of negotiation of commission rates on orders exceeding $300,000 does not evidence significant regulatory problems.[9] We conclude that CBOE's re-

[7] The Antitrust Division of the U.S. Department of Justice.

[8] See Securities Exchange Act Release No. 9950, pp. 96–108 (January 16, 1973).

[9] *Ibid.*

quirement for negotiation above $30,000 is comparable to the general requirement of negotiated commission rates we previously have enunciated and comports with our general finding that negotiation on large institutional-sized orders is appropriate in the public interest. As we continue our review of the appropriateness of further reductions in the breakpoint for negotiated rates, CBOE will be included in any determinations we may make. In view of these circumstances, we do not find CBOE's proposed rule relating to rates to be unreasonable.

Recognizing CBOE as an experimental project, we believe it would be unwise, at the outset, to cast CBOE into a preconceived mold. We believe it is appropriate, therefore, pending further conclusions regarding the viability of existing fixed commission rates and the nature of CBOE's actual operations, to permit CBOE to structure its commission rates in a manner analogous to those provided by all of the existing exchanges.[10] For these reasons CBOE will be permitted to begin operations with the prevailing exchange practice of fixed minimum rates on portions of orders below an appropriate breakpoint incorporated in its rules.[11] It is understood that CBOE's fixed rates shall continue only so long as they exist on other exchanges and that the breakpoint at which

[10] We previously have enunciated our view that the structuring of a central market system is appropriate in the public interest and that such a system may require a large measure of uniformity. With the advent of increased interest in trading in options, it is difficult to predict what, if any, role in such a central market system CBOE will play. But we do not believe it is appropriate to *mandate* differences in treatment of such fundamental matters as commission rates until further experience with the CBOE pilot project is obtained.

[11] CBOE Rule 14.3.

competitively determined rates begin shall be appropriately adjusted when breakpoints lower than $300,000 are adopted by other exchanges. We are of the opinion that this approach is consistent with the standards of the Exchange Act.

We note that, in connection with the registration of CBOE (and the reported consideration also being given by certain registered exchanges to trading options), we have recently issued three releases proposing new Rule 9b–1,[12] discussed above, and Rule 12a–6,[13] and proposing an amendment to Rule 3a11–1 [14] under the Exchange Act.

Proposed Rule 12a–6 would provide an exemption from the registration provisions of Section 12(a) of the Exchange Act for securities underlying options where the option is itself registered on the national securities exchange in question, the underlying security is registered and listed on another national securities exchange, and the exchange upon which the option is listed limits its activity in the underlying securities to effecting exercises of the options. The proposed amendment to Rule 3a11–1 would clarify the term "equity security" to specifically include calls and puts.

An appropriate order granting exchange registration will issue.

By the Commission (Chairman Casey and Commissioners Herlong and Loomis); Commissioner Owens dissenting.

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[12] Securities Exchange Act Release No. 9930 (January 9, 1973).

[13] Securities Exchange Act Release No. 9931 (January 9, 1973).

[14] Securities Exchange Act Release No. 9929 (January 29, 1973).

ORDER GRANTING REGISTRATION AS NATIONAL SECURITIES EXCHANGE

The Chicago Board Options Exchange, Inc., having filed an application with the Commission for registration as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934; and

It appearing to the Commission that the rules of said exchange provide for the expulsion, suspension or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the willful violation of any provisions of the Act, or of any rule or regulation thereunder, shall be considered conduct or proceeding inconsistent with just and equitable principles of trade; and

It further appearing that said exchange is so organized as to be able to comply with the provisions of said Act and the rules and regulations thereunder, and that the rules of said exchange are just and adequate to insure fair dealing and to protect investors;

It is ordered that the application of The Chicago Board Options Exchange, Inc. for registration as a national securities exchange be, and it hereby is, granted.

By the Commission.

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